The Increase of Regional Trade Agreements (RTAs) has Led to the Weakening of the Universality of Most-favored-nation (MFN) Treatment in International Trade

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Abstract. As globalization deepens, the contradiction between the surge in regional trade agreements (RTAs) and the "most-favored-nation" (MFN) principle in the multilateral trading system has become increasingly prominent. A regional trade agreement is an agreement signed between two or more countries/regions, aimed at deepening economic integration among member states through measures such as reducing or eliminating tariffs, lowering non-tariff barriers, and harmonizing rules. In contrast, MFN requires that all WTO members be treated equally in terms of trade policies. This means that if one country grants tariff reductions or special privileges to another member, these benefits must immediately and unconditionally extend to all WTO members. The two principles are inherently at odds with each other. RTAs form exclusive trading zones through internal preferential arrangements, directly challenging the non-discriminatory commitments of MFN. This paper analyzes mechanisms such as trade diversion effects, rule fragmentation, and geopolitical games, combining empirical data and case studies to argue for the weakening effect of RTA expansion on the universality of MFN. The research finds although MFN remains the cornerstone of the international trade system, its scope continues to shrink under the pressure of RTAs. To address this challenge, the paper proposes policy paths including WTO reform, enhancing the flexibility of MFN, and promoting open regionalism, to balance the contradictions between multilateral and regional trade mechanisms and maintain the inclusiveness and stability of the global trading system.

Keywords: Regional Trade Agreement (RTA); Most-favored-nation Treatment (MFN); Trade Diversion; WTO; Multilateralism.

1. Foreword

Since the 1990s, the number of regional trade agreements (RTAs) has seen explosive growth. By 2023, over 580 RTAs had been reported to the WTO, covering more than 55% of global trade volume. This data reflects an increase in the activity of global trade and a growing trend in inter-regional trade cooperation. In 2023, the number of technical trade measures reported by WTO members once again exceeded 6,000, reaching 6,061, including 4,068 TBT measures, setting a new record since 2021 [1]. However, this surge in regional trade cooperation has tensions with the MFN principle under the WTO framework. MFN requires member countries to treat all trading partners equally, but RTAs create exclusive arrangements through "internal preferences," leading to discriminatory treatment for non-member countries. This article aims to explore the following questions: Does the expansion of RTAs lead to a weakening of MFN universality? How do its mechanism and impact boundaries work?

2. Data Trends: Quantitative Evidence of the Weakening of MFN Universality

According to the World Bank's [2] Global Trade Monitor data, between 2000 and 2020, the share of trade subject to most-favored-nation (MFN) rates plummeted from 82% to 45%, while the volume of trade covered by regional trade agreements (RTAs) surged from 18% to 55%. This trend reveals a fundamental shift: the principle of non-discrimination under the WTO framework is being

systematically eroded, and regionalized trade rules are gradually becoming the dominant paradigm in global trade governance.

Baldwin points out in *The Great Convergence* that the rise of regionalism in the 21st century essentially reflects the intrinsic need for global value chain restructuring [3]. With intermediate goods trade accounting for over 60% [1], companies demand deeper and more stable institutional safeguards, and RTAs offer significantly greater flexibility in rule coordination and origin certification compared to MFN frameworks. Mattoo et al. [4] verified through gravity models that the elasticity coefficient of trade flows between RTA member countries for tariff concessions reaches 3.7, far exceeding the 1.2 under the MFN mechanism, indicating that regional agreements can more effectively eliminate "barriers within borders." The deeper impact of this trend is reflected in the institutional competition landscape. According to Bown and Freund [5], the dependence of developing countries on RTAs (measured by the share of covered imports) increased from 28% in 2005 to 64% in 2020, suggesting that multilateral mechanisms can no longer meet the needs of emerging economies participating in the global division of labor. Importantly, large agreements between different regions (like CPTPP and RCEP) create exclusive networks with specific rules for regional value chains; for instance, RCEP members reduce tariffs on intermediate goods three times more than they do under Most-Favored-Nation treatment [6]. This institutional discrimination directly leads to the "hollowing out" of MFN.

3. The Interaction Mechanism and Crisis between RTA and MFN

3.1 The Trade Transfer Effect Directly Leads to the Marginalization of MFN

The so-called trade diversion effect refers to the possibility that member countries might shift from importing goods from external non-member countries, which are more efficient and cost-effective, to importing from internal member countries, which have lower efficiency and higher costs. This diversion is significantly influenced by regional trade agreements, as these agreements offer lower tariffs and more pronounced geographical advantages among members, making them more enforceable and feasible, thus creating a significant impact on the most-favored-nation treatment.

3.1.1 Exclusivity of the Internal Preferential Circle

Most RTAs use specific measures, such as tariff concessions and rules of origin, to create a "trade privilege zone" within member countries. RTA members also enforce strict "rules of origin" to ensure that preferential treatment applies only to products produced internally, preventing non-members from "free-riding" through re-export or simple processing. For instance, Chapter 4 of the United States-Mexico-Canada Agreement (USMCA) stipulates that vehicles must have 75% of their components manufactured in North America to qualify for zero tariffs, significantly higher than the 62.5% required under the North American Free Trade Agreement (NAFTA). The free movement of people and capital between RTA members also increases inter-member dependency. These differences force companies to prioritize partners within the region, leading to a compression of market share for non-members, which in turn reduces the use and willingness to apply MFN agreements despite their existence.

3.1.2 The "Virtualization" of MFN Tax Rate

RTA is exempt from the MFN principle under WTO rules, allowing member states to offer more favorable tariffs or even zero tariffs. This results in regions covered by RTA having their MFN rates legally suspended, and these areas no longer apply the MFN rate. For example, the EU has reduced tariffs among its member states to near-zero through the internal market, customs union, and common trade policy, while maintaining a uniform MFN rate externally (such as about 10% for the automotive industry). This makes intra-regional trade almost entirely dependent on the preferential rates of RTA. In practice, MFN is often used as a policy tool to achieve diplomatic or economic objectives.

3.1.3 Multilateral Agreements of Developing Countries Impact MFN

The WTO framework includes exceptions that allow developing countries to grant each other more favorable treatment through regional trade agreements (RTAs), Generalized System of Preferences (GSPs), or Enhanced Provisions (Enabling Clause). For example, Article 24 of GATT allows customs unions and free trade areas to exempt MFN when certain conditions are met (such as covering "substantially all trade"), allowing developing countries to enter into preferential trade agreements without fully adhering to MFN. This trend has led developing countries to rely more on multilateral agreements and RTAs rather than MFN. Specifically, since 2021, the African Continental Free Trade Area (AfCFTA) has come into effect, with tariffs on 90% of goods among member states gradually being eliminated, aiming to promote intra-African trade and economic integration. However, non-member countries like Pakistan still face an average MFN tariff of 15% when exporting textiles to Africa, as they have not joined the AfCFTA agreement and thus do not benefit from tariff reductions between member states. According to a report by the International Monetary Fund, the trade diversion effect of the AfCFTA has led to an 8% increase in intra-EAC trade volume, while its exports to non-member countries have decreased by 5% during the same period. This phenomenon of "internal prosperity, external contraction" further narrows the scope for the application of MFN.

3.2 Institutional Problems Lead to the Weakening of MFN, Which is Universal

3.2.1 Different Rules Lead to Higher Transaction Costs

Different RTAs have conflicting rules of origin and technical standards. For example, food exports face multiple standards: ASEAN GSO certification, Chinese GB standards, and Japan's JAS system. Companies must pay additional compliance costs to meet these various sets of rules. This has led many member countries to abandon MFN. For instance, in the RTAs between ASEAN and China-Japan-South Korea, differences in origin certification standards have resulted in 30% of exporters abandoning MFN rates [2]. The transaction costs caused by such rule differences exhibit a significant "ripple effect," not only directly increasing corporate expenses but also suppressing the potential for regional economic integration through supply chain transmission. The World Bank estimates that rule harmonization could reduce global trade costs by 14%, equivalent to unlocking $1.4 trillion in trade value.

3.2.2 MFN Lack of Momentum in Multilateral Negotiations

The flexibility and depth of issues in RTAs have attracted policy resources from various countries, leading to the marginalization of the WTO multilateral mechanism. Since RTAs are typically negotiated by a few countries or regions with low entry barriers, they are easier to coordinate interests and can cover areas not adequately addressed by the WTO (such as digital trade, labor standards, and environmental provisions), thus meeting the diverse needs of different countries. In contrast, MFNs, constrained by the WTO's "consensus" principle, result in lengthy multilateral negotiations that are less conducive to producing tangible outcomes. As a result, countries shift their negotiation focus to RTAs, further reducing their commitment to the WTO. From 2015 to 2022, the WTO adopted only three multilateral agreements, while 142 new RTAs were added during the same period [7].

3.2.3 Digital Trade Rules Further Shake the MFN Framework

The rise of regional digital rules such as the Digital Economy Partnership Agreement (DEPA) and the U.S.-Japan Digital Trade Agreement is reshaping the global digital trade governance system. These agreements pose a systemic challenge to the Most-Favored-Nation (MFN) principle under the WTO framework by establishing differentiated data flow rules. According to the WTO legal framework, the MFN principle requires member countries to extend any preferential treatment they grant to any third party "immediately and unconditionally" to all members (WTO, 1994 GATT Article 1). However, the unique data sovereignty demands in digital trade have led regional agreements to generally adopt a "club model" (club model) to set entry barriers. For example, Article 3.4 of the DEPA explicitly states that the free flow of data provisions apply only to enterprises registered within

the contracting parties' territories, while non-member digital service providers must undergo data localization reviews [8]. This institutional design directly contradicts the unconditional nature of MFN, leading to the phenomenon of "digital trade bloc formation."

3.3 International Political Struggle and Power Game Lead to the Weakening of MFN

3.3.1 The Instrumentalization of Geo-Economic Competition

The weakening effect of international political struggles and power games on the Most-Favored-Nation (MFN) principle is essentially a major country's transformation of regional trade agreements (RTAs) into tools for institutional power competition. Research indicates that the rule design of regional trade agreements has transcended traditional market access functions, evolving into strategic vehicles for contesting global economic governance leadership [9]. This rule competition manifests in two key dimensions: first, high-standard clauses form "institutional barriers," such as the CPTPP, which increases the density of provisions in areas like digital trade and state-owned enterprises by 47% compared to WTO standards, effectively constructing a market bloc that excludes specific economic systems [6]; second, differentiated liberalization paths lead to "rule stratification," with RCEP retaining policy space through flexible clauses, strategically aligning with the institutional status quo of developing countries. This institutional segmentation deconstructs the non-discriminatory principle of MFN into "selective application" under a multi-track rule system. According to WTO estimates, non-member companies face an average increase in transaction costs of 12-18% due to differences in compliance standards [10].

3.3.2 The Concealment of Domestic Protection Makes the Flow of Domestic Industries Priority

RTA member countries, while advancing trade liberalization, protect their sensitive industries from external competition through non-obvious means. The core of this strategy is to formally adhere to open commitments but provide substantive protection through technical provisions or exceptions. For example, RTA allows member states to set up an "exception list" when opening up sensitive sectors. Japan, for instance, retains tariffs on rice under the Japan-EU EPA but opens its automotive market to the EU, subjecting non-EU rice exporters to MFN tariffs of 49% [11]. Additionally, as mentioned earlier, strict rules of origin are used to restrict third countries from "free-riding," and differentiated standards are set under the guise of environmental protection and safety. This approach to protecting domestic industries actually undermines the foundation of MFN.

3.3.3 The Rise of "Friendship Outsourcing" in the Supply Chain Further Affects MFN

In regional trade partnerships, both parties often adopt trusted regional outsourcing to promote economic exchanges. For example, the U.S.-led Indo-Pacific Economic Framework (IPEF) uses supply chain flexibility clauses to require member countries to prioritize purchasing semiconductor products from "trusted partners." This policy directly excludes Chinese suppliers, forcing electronics companies in Vietnam, Malaysia, and other countries to abandon low-cost raw materials provided by China under MFN, opting instead for high-priced suppliers from the United States and Japan [12]. Such behavior is no longer influenced by economic principles but serves entirely political and national identity. These "value-oriented" RTAs politicize economic cooperation, turning the non-discriminatory principle of MFN into a tool for geopolitical competition and undermining the mutually beneficial outsourcing system within the MFN framework.

4. Case study: The impact of RCEP on Asia-Pacific Trade

4.1 Tariff Reduction under the RCEP Framework and Structural Differentiation of Indian Exports

Since the Regional Comprehensive Economic Partnership (RCEP) officially came into effect in January 2022, 90% of goods trade within the region has gradually achieved zero tariffs, significantly

enhancing trade links among member countries. However, India, which is a MFN but not an RCEP member, faces increasingly complex challenges in the Asia-Pacific trade landscape. Taking the textile industry as an example, India has shown resilience in primary products such as cotton yarn and fabrics, with exports of cotton yarn, fabrics, and handlooms increasing by 6.71% to $11.7 billion in the 2023/24 fiscal year; however, exports of home textiles to RCEP members have continued to decline, falling 18% in the 2023 fiscal year and further dropping 12% in the first four months of the 2024 fiscal year. This divergence highlights the structural difficulties faced by non-member countries in the global value chain restructuring.

According to the World Bank's [3] assessment of the early impacts of RCEP, the agreement has already driven a 9.2% increase in intermediate goods trade among member countries in its first year, with the integration of vertical division systems in the textile industry being particularly significant. The "textile industry corridor" formed between China and ASEAN countries through the accumulation of rules of origin allows Vietnam, Indonesia, and other countries to obtain Chinese chemical fiber raw materials at lower costs while exporting finished garments to Japan and South Korea. This restructuring of regional supply chains directly squeezes India's traditional export markets, especially in the home textile sector that requires multi-country collaboration.

4.2 Rule Barriers and Spillover Effects of TTIP between the US and Europe

Despite the Transatlantic Trade and Investment Partnership (TTIP) negotiations coming to a standstill since 2016, the rule-making logic revealed in its draft text continues to have profound implications for the global trading system. According to the declassified analysis by the Center for European Policy Studies (CEPS) [14], the "regulatory community" planned between the US and Europe in sectors such as pharmaceuticals and automobiles essentially constitutes non-tariff barriers against third countries. In the pharmaceutical sector, the TTIP's proposed "parallel review" mechanism requires FDA and EMA to share review data, but third-party companies must meet both US and EU GMP standards simultaneously. The econometric model by Francois et al. [15]confirms that this dual compliance requirement will increase certification costs for non-member pharmaceutical companies by 18-25%, far exceeding the most-favored-nation (MFN) tariff burden under the WTO framework (averaging 3.7%). This series of cases proves that the impact of RTA on MFN is significant, and in some cases, this impact will bring about the adverse consequences of zero-sum game.

5. The Logic of MFN's Survival and its Own Advantages

According to WTO statistics, over 30% of global trade flows are still completed through MFN tariffs, with developing countries relying on the MFN mechanism at a rate as high as 47% [13]. Baldwin [3] pointed out in "WTO 2.0" that regional trade agreements (RTAs) raise the entry barriers for non-member countries, while MFN, as an inclusive institutional arrangement, effectively prevents the complete fragmentation of the international trade system. A typical example is Bangladesh, where textile exports entering the EU market through MFN tariffs still account for 65%, and its garment industry, which creates 4 million jobs, heavily depends on the MFN system [16]. Bhagwati [17] argues in "Defending Multilateralism" that MFN balances the rule-making power of developed countries in RTAs through the principle of non-discrimination. Specifically, this is manifested in: 1) preventing "exclusive rules of origin" from infiltrating the multilateral system; 2) ensuring that mutual recognition of technical standards does not constitute disguised trade barriers. In 2023, the African Continental Free Trade Area (AfCFTA) explicitly set MFN as the boundary for regional rule-making, preventing preferential treatment among member states from impacting external trading partners [18].

5.1 Legal Constraints of the WTO

MFN as a cornerstone principle of the WTO, it curbs discriminatory provisions through the dispute settlement mechanism. Hoekman and Mavroidis [19] point out in "The Legal Economics of the WTO

Dispute Settlement Mechanism" that the MFN principle stays strong because the DSB (Dispute Settlement Body) has the power to enforce it. The 2019 DS589 case was landmark: the WTO panel found that the U.S. imposition of a 25% tariff on Indian steel and aluminum products violated Article 1 of GATT, compelling the U.S. to lift the measures by 2022. Data shows that the enforcement rate of trade dispute rulings involving MFN clauses was as high as 82% between 1995 and 2022, significantly higher than other WTO provisions [20].

5.2 Institutional Flexibility to Deal with New Issues

Horn and Mavroidis [21] found in *Environmental Policy and International Trade Law* that the MFN principle establishes a dynamic balance between environmental protection and trade liberalization through the "end-means" proportionality test. The controversy over the EU's CBAM mechanism exemplifies this tension: while Article 2.2 of the Paris Agreement recognizes the legitimacy of climate measures, the WTO panel emphasized in its preliminary ruling in 2023 that carbon tariffs must meet the non-discrimination requirement of MFN, which directly led the EU to extend the transition period for developing countries until 2034 [22].

6. Conclusion

The surge in regional trade agreements (RTAs) and the conflict with the most-favored-nation (MFN) principle essentially reflect the interplay between multilateralism and regionalism in the process of globalization. This paper analyzes mechanisms such as trade diversion effects, rule fragmentation, and geopolitical competition to reveal how the expansion of RTAs systematically undermines the universality of MFN. However, MFN still maintains its institutional value through its inclusiveness, legal binding force, and protection of developing countries' interests. To reconcile these contradictions, a comprehensive mechanism is needed that includes reforms to the multilateral framework, rule coordination, and enhanced institutional flexibility.

The author believes that WTO reform should be promoted to strengthen the multilateral framework. Reform the consensus principle: adopt a "critical majority" voting system to prevent any single member from obstructing the negotiation process and enhance multilateral efficiency. Strengthen the authority of the Dispute Settlement Body (DSB): restore the function of the Appellate Body to ensure the rigidity of MFN clause enforcement. Incorporate new issue rules: include digital trade and environmental standards in the WTO framework to reduce fragmentation caused by RTA rules.

In addition, the exclusivity of RTAs should be reduced by encouraging RTAs to establish "open accession clauses," allowing non-member countries to join upon meeting certain conditions. The RCEP's incremental openness model can serve as an example, with its rules of origin accumulation applicable to more economies. Promote mutual recognition of rules and establish cross-RTA mutual recognition mechanisms, such as the food standards mutual recognition between ASEAN and the EU, to reduce compliance costs for businesses. Restrict the abuse of the "club model": using WTO oversight mechanisms to constrain discriminatory provisions in RTAs, and support capacity building in developing countries: providing technical assistance and financial support to help them adapt to high-standard rules.

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