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**Sixth report on the Most-Favoured-Nation Clause by Mr. Endre Ustor, Special Rapporteur -
draft articles with commentaries (continued)**

Topic:

Most-favoured-nation clause

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MOST-FAVOURED-NATION CLAUSE

[Agenda item 3]

DOCUMENT A/CN.4/286*

Sixth report on the most-favoured-nation clause by Mr. Endre Ustor, Special Rapporteur

*Draft articles, with commentaries (continued)***

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* Incorporating document A/CN.4/286 and Corr.1.

** For the draft articles already proposed by the Special Rapporteur, see the third, fourth and fifth reports (*Yearbook...1972*, vol. II, p. 161, document A/CN.4/257 and Add.1; *Yearbook...1973*, vol. II, p. 97, document A/CN.4/266 and *Yearbook...1974*, vol. II, (Part One), p. 117, document A/CN.4/280).

ABBREVIATIONS

ECSC	European Coal and Steel Community
EEC	European Economic Community
EURATOM	European Atomic Energy Community
GATT	General Agreement on Tariffs and Trade
I.C.J.	International Court of Justice
<i>I.C.J. Reports</i>	<i>I.C.J., Reports of Judgments, Advisory Opinions and Orders</i>
OECD	Organisation for Economic Co-operation and Development
OEEC	Organisation for European Economic Co-operation
P.C.I.J.	Permanent Court of International Justice
<i>P.C.I.J., Series A/B</i>	<i>P.C.I.J., Judgments, Orders and Advisory Opinions</i>

I. Proposals concerning the draft articles on the most-favoured-nation clause adopted by the Commission¹

1. In his fifth report,² the Special Rapporteur proposed several draft articles dealing with national treatment and the national treatment clause (articles 9 *et seq.*). The reasons for doing so were briefly given in paragraph 1 of the commentary to articles 9 and 10.

2. The Special Rapporteur still believes that the draft cannot, without a risk of incompleteness, avoid dealing with the national treatment clause and national treatment in parallel to the study of the most-favoured-nation clause and most-favoured-nation treatment. Owing to the close relationship between the two kinds of treatments and the respective clauses, this may not cause particular difficulties.

3. From the point of view of drafting, the inclusion of provisions on national treatment clauses in articles concerning most-favoured-nation clauses can be done in at least four ways:

(a) By leaving the articles on most-favoured-nation clauses intact and inserting a provision indicating which of those articles are applicable, *mutatis mutandis*, to national treatment clauses; this method was not followed by the Commission in the context of other topics;

(b) By introducing into the draft articles the term "a clause" and explaining in the article on the use of terms that the term "a clause" means "a most-favoured-nation clause or a national treatment clause, as the case may be"; this term would then be used in all the articles applicable to both kinds of clauses;

(c) By adopting two groups of articles as two separate chapters in the draft: one on the most-favoured-nation clause and a second on the national treatment clause; a third chapter would be added concerning cases of cumulation of the two clauses and on the absorption of the latter by the former;

(d) By mentioning explicitly both the most-favoured-nation clause and the national treatment clause in the articles applicable to both.

4. The Special Rapporteur, while not having very strong views against the methods mentioned in subparagraphs (b) and (c) of the preceding paragraph, proposes to follow the method indicated in subparagraph (d). This, it is submitted, leads to the adoption of a text which although not as terse as that which could be reached by following the system mentioned in subparagraph (b), will make easier reading and avoid cumbersome repetition, an inevitable consequence of the method described in subparagraph (c).

5. In the light of the foregoing, the proposals concerning individual articles are as follows:

Revised article 1. Scope of the present articles

The present articles apply to most-favoured-nation clauses and national treatment clauses contained in treaties between States.

Revised article 2. Use of terms

For the purposes of the present articles:

(a) . . .

(b) "granting State" means a State which grants most-favoured-nation treatment or national treatment as the case may be;

(c) "beneficiary State" means a State which has been granted most-favoured-nation treatment or national treatment as the case may be;

(d) . . .

Revised article 3. Clauses not within the scope of the present articles

The fact that the present articles do not apply (1) to a clause on most-favoured-nation treatment or on national

¹ Articles 1 to 7. See *Yearbook... 1973*, vol. II, pp. 213 *et seq.*, document A/9010/Rev.1, chap. IV, sect. B.

² *Yearbook... 1974*, vol. II (Part One), p. 117, document A/CN.4/280.

treatment contained in an international agreement between States not in written form, ...

(a) . . .

(b) . . .

(c) The application of the provisions of the present articles to the relations of States as between themselves under clauses by which States undertake to accord most-favoured-nation treatment or national treatment to each other, when such clauses are contained in international agreements in written form to which other subjects of international law are also parties.

COMMENTARY TO REVISED ARTICLES 1 TO 3

Revised articles 1 and 2 are self-explanatory. Some explanation is needed as to why no change is proposed in the wording of parts (2) and (3) of the first paragraph of article 3. As to part (2) it seems impossible *ex definitione* that a State accord national treatment to a subject of international law other than a State, i.e. to an international organization, regarding the treatment of such organization with respect to itself. It is, hypothetically, not impossible that national treatment be accorded to an international organization in respect of its property or its officials. However, the Special Rapporteur is not aware of the existence of such clauses and hence does not propose to provide for this hypothesis. As to part (3) of the first paragraph of article 3 it is believed that the according of national treatment by a subject of international law other than a State is *ex definitione* impossible.

Article 4. *Most-favoured-nation-clause* and Article 5. *Most-favoured-nation-treatment*

6. These articles need not be revised. On the occasion of putting the articles in a definitive order, however, they will have to be arranged together with draft article 9 (national treatment clause) and article 10 (national treatment) proposed in the Special Rapporteur's fifth report.³

Revised article 6. *Legal basis of most-favoured-nation treatment and national treatment*

Nothing in the present articles shall imply that a State is entitled to be accorded most-favoured-nation treatment or national treatment by another State otherwise than on the ground of a legal obligation.

COMMENTARY

This revised article extends the rule adopted in respect of most-favoured-nation treatment (art. 6) and makes it applicable to national treatment as well. The validity of the general statement that neither most-favoured-nation treatment nor national treatment can be claimed from another State unless the latter has a legal obligation to extend it seems to be beyond dispute. However, the

background of the rule and its actual content seem to be somewhat different in respect of these two types of treatment. With regard to the most-favoured-nation treatment, the meaning of the rule is, for all practical purposes, that such treatment cannot be claimed except on the basis of a most-favoured-nation clause, i.e. under the provision of a treaty promising most-favoured-nation treatment. The situation is similar but not exactly the same regarding national treatment. It may be true that in most fields, e.g. in that of shipping or in establishment matters, national treatment for the ships or nationals of a country cannot be claimed except on the ground of an appropriate treaty provision. However, among human rights and fundamental freedoms there are many which are equally due to nationals and foreigners and in regard to which, therefore, national treatment has to be granted even in the absence of a specific treaty obligation. In regard to the right to liberty and security, to equality before the courts and tribunals, to protection against interference with one's privacy, family, home or correspondence, to freedom of thought, conscience and religion, etc., the obligation to grant national treatment to all aliens lawfully in the territory of a State rests upon generally recognized customary international law. Thus, there are fields where the granting of national treatment is compulsory under general international law and where the denial of such treatment constitutes a violation of international law. This is not the case regarding most-favoured-nation treatment, which States cannot generally claim from one another except on the basis of a treaty stipulation.⁴ Because, however, revised article 6 covers both situations, it is proposed to adopt it in its newly presented wording.

Article 7. *The source and scope of most-favoured-nation treatment*

7. It is not proposed to make any change in the wording of the title or in the text of article 7. It would seem appropriate, however, to adopt an article parallel to article 7 on the source and scope of national treatment. The Special Rapporteur submits, therefore, the following draft for the consideration of the Commission:

Article X. *The source and scope of national treatment*

Without prejudice to the rules of general international law on the treatment of aliens lawfully in the territory of a State, the right of the beneficiary State to obtain from the granting State national treatment arises from the national treatment clause in force between the granting State and the beneficiary State.

COMMENTARY

The reasons for introducing the article by the phrase "without prejudice . . ." are the same as those given in the commentary on revised article 6. Article X, which is a parallel article to article 7 is drafted in a simpler way than

³ *Ibid.*, p. 124.

⁴ See para. 4 of the commentary to article 6.

the latter. It is believed, however, that its meaning is clear if read together with article 10 (fifth report) defining the term "national treatment".

II. Proposals concerning the draft articles presented by the Special Rapporteur in his fourth and fifth reports and additional commentaries

8. In the fourth report, article 6 was presented under the title "Presumption of unconditional character of the clause".⁵ In the fifth report it was proposed that the text of article 6 should be reduced to its first phrase.⁶ This shorter version is proposed anew with a more precise title and with a parallel article on the national treatment clause as follows:

Revised article 6. Presumption of unconditional character of the most-favoured-nation clause

Except when in appropriate cases most-favoured-nation treatment is accorded under the condition of material reciprocity, the most-favoured-nation clause is unconditional.

Article Y. Presumption of unconditional character of the national treatment clause

Except when national treatment is accorded under the condition of material reciprocity, the national treatment clause is unconditional.

COMMENTARY TO REVISED ARTICLE 6 AND ARTICLE Y

(1) The reader is respectfully referred to the commentaries on article 6⁷ and on articles 6 *bis* and 6 *ter*.⁸

(2) As the text of revised article 6 is unchanged and only its title shows a slight alteration, the novelty of the proposal lies in article Y. This article states the same presumption of unconditionality regarding the national treatment clause as exists in regard to the most-favoured-nation clause. This presumption clearly follows from the general principles of treaty interpretation. It is also believed to be consistent with the constant practice of States. In a letter from the Foreign Minister of France dated 22 July 1929, already cited,⁹ it was stated:

... when treaties provide for national treatment without making such treatment conditional on reciprocity, the question of whether a French national enjoys the same advantages in the territory of the other country no longer arises.¹⁰

⁵ See *Yearbook...* 1973, vol. II, p. 98, document A/CN.4/266.

⁶ See *Yearbook...* 1974, vol. II (Part One), p. 118, document A/CN.4/280, para. 1 of the commentary to articles 6 *bis* and 6 *ter*.

⁷ See *Yearbook...* 1973, vol. II, p. 98, document A/CN.4/266.

⁸ See *Yearbook...* 1974, vol. II (Part One), p. 118, document A/CN.4/280, paras. 1 and 2 of the commentary to articles 6 *bis* and 6 *ter*.

⁹ *Ibid.*, p. 126, commentary to articles 11 and 12.

¹⁰ Quoted by Mme M. Simon-Depitre in *Juris-classeur de droit international* (Paris, Editions techniques), vol. V, fasc. 523, p. 26, para. 66.

The learned commentator explains the text as follows:

An imbalance may result in the sense that the protection of nationals may be more effective in one country than in another, and their rights more extensive.¹¹

She states further:

Since the national treatment clause is the broadest and entails in principle the maximum sacrifices for the country which subscribes to it, the courts have tended to follow their restrictive inclination and to admit in cases where there is doubt, and even on occasion in cases where there is no doubt, a qualification other than that of assimilation to nationals. The most typical example is that of the Franco-Spanish Convention of 7 January 1862, article 1 of which provides that:

"The subjects of the two countries may travel and reside in the respective territories as nationals, establish themselves in places which they consider appropriate for their interests, acquire and own any kind of movable property or real estate, engage in any kind of industry, carry on both wholesale and retail trade, lease any houses, shops and stores which they may find necessary, effect the transport of goods and money and receive shipments both from within the country and from abroad, subject to payment of the duties and taxes and observance, in all cases, of the conditions laid down in the laws and regulations applicable to nationals".

The interpretation of this text has been one of the reasons for the conflict between the Government and the courts with respect to the granting of the right to own commercial property to foreigners enjoying the protection of diplomatic treaties: the Court of Cassation (*Cass. civ.*, 22 December 1931: *D.P.*, 1932, vol. 1, p. 131, comment by *Trasbot*; *Series 1932*, vol. 1, p. 257, comment by *Niboyet*; *Gaz. Pal.*, 1932, vol. 1, p. 205. — 24 February 1932: *Series 1932*, vol. 1, p. 249, comment by *H. Mazeaud*) took the view that the article constituted a reciprocal clause within the meaning of article 11 of the Civil Code and it called for proof of the existence in Spain of legislation analogous to the French law on commercial property, despite the conflicting interpretation given by the Minister for Foreign Affairs (*letter of 22 July 1929*, loc. cit., No. 65). The Court of Cassation subsequently revoked this interpretation and granted the Spanish the right to own commercial property (*Cass. civ.*, 16 February 1937; *Gaz. Pal.*, 1937, vol. 2, p. 687).¹²

(3) Revised article 6 states the presumption of the unconditional character of the most-favoured-nation clause. Articles 6 *bis* and 6 *ter*¹³ give the details as to the effect of an unconditional most-favoured-nation clause and to that of a most-favoured-nation clause conditional on material reciprocity. The same method is now followed regarding the national treatment clause. Article Y states the analogous presumption of unconditionality, whereas articles 11 and 12¹⁴ explain the effect of an unconditional national treatment clause and that of a national treatment clause conditional on material reciprocity. As a result, the order of the articles will have to be rearranged.

Revised article 7. The ejusdem generis rule

Under a most-favoured-nation clause or a national treatment clause the beneficiary State cannot claim any other rights than those relating to the subject-matter of the clause and falling within the scope of the clause.

¹¹ *Ibid.*

¹² *Ibid.*, para. 67.

¹³ *Yearbook...* 1974, vol. II (Part One), p. 118, document A/CN.4/280.

¹⁴ *Ibid.*, p. 126.

COMMENTARY

(1) Revised article 7 differs from the original article 7¹⁵ in so far as it refers not only to the most-favoured-nation clause but also to the national treatment clause. Indeed, the national treatment clause is just as much subject to the *ejusdem generis* rule as the most-favoured-nation clause. This seems to be self-evident and in no need of a detailed explanation. The beneficiary State of a national treatment clause is in this regard in a position similar to the beneficiary State of a most-favoured-nation clause: it cannot claim an advantage of a kind other than that stipulated in the clause.

(2) In the case referred to below, the court rejected a claim based on national treatment clauses on the ground that the treatment claimed was not covered by the clauses upon which the claimant relied.

Heaton v. Delco Appliance Division, General Motors Corp.

This was an appeal by a British subject from a decision of the Workmen's Compensation Board which directed the payment to him, as an alien, of only one half of the commuted amount of the compensation to which a citizen of the United States would be entitled.³⁵ The appellant maintained that he was entitled to the same rights as a citizen of the United States under article X of the Treaty of Amity, Commerce, and Navigation between the United States and Great Britain (the Jay Treaty), signed in London on 19 November 1794, and articles II and V of the Convention between the United States and Great Britain relating to the Tenure and Disposition of Real and Personal Property, signed at Washington on 2 March 1899. The Court, which affirmed the decision of the Workmen's Compensation Board, said:

"Considering the terms, conditions and circumstances under which article X became part of the Treaty of 1794 and giving to it the most favourable interpretation, it was never intended by the contracting parties to include our present day form of compensation between employer and employee or anything vaguely similar to it that might have been in effect at the time of the treaty. Its purpose was, by a Treaty of Amity, Commerce and Navigation, to terminate the differences without respect to the merits; to produce mutual satisfaction and understanding; to regulate the commerce and navigation so as to render the same reciprocal to the benefit and satisfaction of both nations. Article X referred to the debts of individuals of both nations and their protection in the event of a war or national differences. It (article X) was primarily to prevent in the future such unlawful confiscations practiced following the Revolutionary War. The article was directed to the rights of the individual as such and ineffective to abrogate Section 17 of the Workmen's Compensation Law of the State of New York.

"We likewise conclude that articles II and V of the Convention of 1899 is of no help or solace to the claimant. The wording of article II is clear that it was intended for the purpose of disposing of personal property by testament, donation or otherwise and it cannot inferentially under any favorable interpretation be construed to have application to the present facts.

"There is no language in the Treaty which can be construed to make claim for death or injuries arising out of the relationship of employer and employee. The right to recover without alleging negligence or fault is given solely and exclusively by the statute of which Section 17 is a part. Even though social legislation such as this is subject to liberal interpretation, it cannot be so interpreted as to abrogate the wording and intent of the statute.

"... As to the Treaty of 1794 and the Convention of 1899 there is nothing in the language, taking into consideration the time, circumstances and conditions when they were written and also the present day circumstances, that can overcome or abrogate section 17 of the Workmen's Compensation Law of the State of New York.

"...

"It has been necessary to document by way of amendment our own Constitution through the years and many new and modern treaties have been executed by this Government and other nations. Section 17, referred to herein, has been described as a harsh statute which finds very little justification in any principle of fairness. However, the fortuitous circumstances here cannot be overcome by judicial interpretation. Our duty is done when we enforce the law as written by the legislative branch of the Government."

³⁵ Section 17 of the Workmen's Compensation Law reads in part as follows: "Compensation under this chapter to aliens ... about to become nonresidents of the United States ... shall be the same amount as provided for residents, except that dependents in any foreign country shall be limited to surviving wife and child or children ... and except that the board, may at its option, or upon the application of the insurance carrier, shall, commute as of the date of death all compensation to be paid to such aliens, by paying or causing to be paid to them one-half of the commuted amount of such compensation as determined by the board. In the case of a resident alien about to become nonresident the future payments of compensation shall be computed as of the date of non-residence".¹⁶

Revised article 8. The most-favoured-nation clause and benefit-restricting stipulations (clauses réservées)

The right of the beneficiary State to most-favoured-nation treatment is not affected by an agreement between the granting State and one or more third States confining treatment to their mutual relations.

Article 8 bis. The most-favoured-nation clause and multilateral agreements

The right of the beneficiary State to most-favoured-nation treatment is not affected by the fact that treatment by the granting State of a third State or of persons or things in a determined relationship with it has been accorded under a multilateral agreement.

COMMENTARY TO REVISED ARTICLE 8 AND ARTICLE 8 BIS

(1) In the commentary on article 8,¹⁷ two hypotheses were envisaged and somewhat blurred. One referred to the existence of a "*clause réservée*" i.e. to cases where the granting State and one or more third States agreed to restrict certain benefits to their mutual relations and intended to exclude from such benefits States which on the basis of most-favoured-nation clauses *ejusdem generis* would be entitled to claim the benefits in question. The other hypothesis referred to in the commentary on article 8 is the case where the treatment due under a most-favoured-nation clause to the beneficiary State has been accorded by the granting State to third States under a multilateral treaty or other multilateral arrangements without being accompanied by a "*clause réservée*". These

¹⁵ *Yearbook...* 1973, vol. II, p. 102.

¹⁶ *Ibid.*, pp. 141-142, document A/CN.4/269, para. 67.

¹⁷ *Ibid.*, pp. 108 *et seq.*, document A/CN.4/266.

two hypotheses or situations differ considerably. In the first, there exists a stipulation of a particular kind (a "clause réservée") between the granting State and one or more third States. This stipulation can be a multilateral undertaking but it can also be bilateral. In the second, no such express stipulation exists, but the benefit-accorded agreement between the granting State and third States is always a multilateral arrangement.

(2) On the basis of the foregoing considerations it would seem that the two situations deserve to be treated in two separate articles. This has been done in the articles presented above as revised article 8 and article 8 *bis*.

(3) Revised article 8 as presented in the Special Rapporteur's fourth report is a new version of article 8. Its title seems to indicate better the content of the text; it remains to be seen, however, whether the arbitrary translation of the expression "clauses réservées" into English will prove to be acceptable. The reference to the possibility of a contrary provision has been omitted from the text. The provision of revised article 8 is, of course, as most, if not all of the articles in the study, of a dispositive character and not *jus cogens*. It seems superfluous to emphasize this character of the provisions in the individual articles.

(4) As to further comments on revised article 8 the reader is respectfully referred to paragraphs 1 to 13 of the commentary to article 8.

The most-favoured-nation clause and multilateral agreements

(5) Article 8 *bis* is new. Paragraphs 14 to 22 of the commentary on article 8 deal with the situation treated in article 8 *bis*. In addition to what has been stated in that portion of the commentary on article 8, the following comments are submitted by the Special Rapporteur explaining the ideas which lead to the presentation of article 8 *bis*.

(6) In paragraph 19 of the commentary on article 8, under the heading "GATT and non-member States", the question was raised: what is the position of third States, not members of GATT? Can they claim under bilateral most-favoured-nation clauses GATT treatment from members? A cautious answer to this question was given in this way: "There is no reason for a negative answer to this question. That some treaties do expressly except GATT favours from the operation of the clauses does not contradict but rather supports this view".¹⁸

That question, however, has been answered in the affirmative by a recognized authority on GATT matters, John H. Jackson, who has written:

Any advantage granted by a GATT contracting party to any other country must be granted to all contracting parties. Thus, advantages granted by a contracting party to a non-GATT member must also be granted to all contracting parties. Consequently, if A and B are GATT members but X is not and A concludes a bilateral trade agreement with X, all advantages given to X in that agreement must also be extended to B. And vice-versa, if the A-X treaty has a MFN

clause, X derives all the advantages that A owes GATT members by virtue of the entire GATT agreement. Thus the impact of GATT goes well beyond its membership.⁹

Some suggestion was made at the 1947 Geneva meetings that GATT benefits should apply only to GATT members, but this idea was rejected.

In some instances the net result is to greatly reduce the incentive for a nation to enter GATT since, if it has a MFN bilateral treaty with its principal trading partners and these partners are GATT members, it obtains most of the advantages of GATT without granting anything to those GATT members with which it has no trade agreement.¹⁰

⁹ U.N. Doc. EPCT/C.II/3, at 14 (1946).

¹⁰ ... This may explain why relatively few Latin American countries have become members of GATT. Among those which are not members are Costa Rica, Ecuador, El Salvador, Paraguay and Venezuela.¹⁹

(7) The following three cases further illustrate the point that most-favoured-nation clauses do attract the benefits accorded by the granting State to third States under multilateral agreements. The first case clearly spells out this point in respect of the Hague Convention on Civil Procedure of 17 July 1905.

A. *Asia Trading Co., Limited v. Biltimex*

The Asia Trading Company, of Djakarta, brought an action in the District Court of Amsterdam against the firm of Biltimex, of Amsterdam. The defendant applied for an order that the plaintiff, being a foreign company, should deposit *cautio judicatum solvi*. The plaintiffs opposed the application.

The Court held that the order for the *cautio* must be refused. This followed from article 24 (paras. 1 and 2) of the Netherlands-Indonesian Union Statute agreed upon on 2 November 1949, which promised the subjects of each partner to the Union treatment on a footing of substantial equality with the other's own subjects, and in any case most-favoured-nation treatment.

The latter provision guaranteed to Indonesians exemption from the *cautio judicatum solvi*, because the Netherlands had previously exempted other foreigners and foreign countries from the *cautio* under the Hague Convention on Procedure in Civil Cases of 17 July 1905.²⁰

(8) The second case serves as negative proof to the above proposition. Although the claim based upon the most-favoured-nation clause is rejected this is done on the ground that the subject-matter of the multilateral treaty in question (the Hague Convention on Procedure in Civil Cases of 17 July 1905) is not *ejusdem generis* as that of the clause upon which the appellant relied. Thus the judgement implicitly acknowledges that in the case where the clause and the multilateral treaty covered the same ground, appellant could not have been denied the benefits of the latter.

¹⁹ J.H. Jackson, *World Trade and the Law of GATT (A Legal Analysis of the General Agreement on Tariffs and Trade)* (Indianapolis, Bobbs-Merrill, 1969), pp. 257-258. See also the Second report (*Yearbook... 1970*, vol. II, p. 230, document A/CN.4/228 and Add.1, paras. 183-187).

²⁰ *Yearbook... 1973*, vol. II, p. 137, document A/CN.4/269, para. 55.

¹⁸ *Ibid.*, p. 114, document A/CN.4/266.

B. *McLane v. N.V. Koninklijke Vleeswarenfabriek B. Linthorst en Zonen*

The appellant, a United States citizen domiciled in Belgium, owed an acknowledged debt to the respondent. When in the Netherlands, he was imprisoned for his debt under an order given by the President of the District Court of Zutphen. The appellant sought to be released by the President of the District Court of The Hague, but his appeal failed. He appealed further to the Court of Appeal of The Hague, relying, *inter alia*, on two treaty provisions by virtue of which, he argued, he should be set free. The first of these was article 24 of the Convention relating to Civil Procedure of 17 July 1905.³⁶ ... The appellant ... relied [*inter alia* – on] article III, section I, of the Netherlands—United States Treaty of Friendship, Commerce and Navigation of 27 March 1956.³⁷

The appellant submitted that he was entitled to benefit from article 24 of the Hague Convention on Civil Procedure through the operation of this most-favoured-nation clause. The Court, which held that the appeal must be dismissed, said:

“... The appellant deems his imprisonment to be illegal on account of its being contrary to Article III, section I, of the Netherlands-United States Treaty of Friendship, Commerce and Navigation, which was ratified by the (Netherlands) Act of 5 December 1957... This provision, assuming it is binding upon everyone, does not prevent a citizen of the United States from being imprisoned in this country under article 768 of the Code of Civil Procedure. Civil imprisonment, indeed, does not run counter to the protection of rights which the Kingdom of the Netherlands under the Treaty owes to citizens of the United States. Moreover, from Article V of the Treaty, as from Article 5 of the annexed protocol of signature, it becomes clear that the Treaty is of limited purport only as far as civil procedure is concerned: civil imprisonment is not referred to, still less precluded. A more liberal interpretation of Article III, section I, as sought by the appellant and under which in this country a citizen of the United States would enjoy the protection of Article 24 of the Convention on Civil Procedure without the United States having acceded to it, is therefore unacceptable to the Court”.

³⁶ Article 24 reads (translation from the official French text):

“Civil imprisonment, whether as a means of enforcement or as a simple preventive measure, may not, in civil or commercial proceedings, be imposed on aliens who are nationals of one of the contracting States in cases where it would not be imposed on nationals of the country. A circumstance which may be invoked by a national domiciled within the country to secure the ending of civil imprisonment must produce the same effect for the benefit of a national of a contracting State, even if that circumstance arises outside the country”.

³⁷ This provision reads:

“Nationals of either Party within the territories of the other Party shall be free from molestations of every kind, and shall receive the most constant protection and security. They shall be accorded in like circumstances treatment no less favourable than that accorded nationals of such other Party for the protection and security of their persons and their rights. The treatment accorded in this respect shall in no case be less favourable than that accorded nationals of any third country or that required by international law”.²¹

(9) In the third case, it has been again expressly recognized that privileges provided pursuant to a “multiple or bipartite international treaty” can be claimed on the basis of a most-favoured-nation clause.

C. *Taxation Office v. Fulgor (Greek Electric Company)*

This decision concerned the application to a Swiss company operating in Greece of the provisions of the Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Kingdom of Greece for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Athens on 25 June 1953.

The Swiss company claimed the application of that convention pursuant to the most-favoured-nation clause included in the agreement ratified by law 3610/1928 on installation and legal protection concluded between Greece and Switzerland. The Greek Council of State said:

“Whereas, as it was considered by this Court ... from the rulings of articles 9 and 11, para. two, of this latter treaty, it becomes evident that the tax privileges provided by any one of the contracting parties to the subjects and firms of the ... third country are extended to the subjects and firms of the other contracting party *de jure* and with no ... barter provided by the third country ... This rightful extension of tax privileges without any barter ... [concerning] the subjects of Greece and Switzerland, takes place in any case ... [regardless of] whether these privileges are provided to the third nation pursuant to home legislation of Greece or Switzerland or pursuant to [a] multiple or bipartite international treaty with the third country and ... [regardless] of the purpose for which they were offered; the more so if this is related to the avoidance of double taxation, since the rulings of above clauses of the Treaty between Greece and Switzerland fail to make any distinction in this respect. Consequently, the application of the rulings of the foregoing Treaty between Greece and Great Britain regarding the income of the Swiss company earned in Greece by virtue of which tax privileges were decreed, was not excluded by the fact that these are included in [the] treaty for the avoidance of double taxation, nor did it depend on the fact ... whether Greek subjects or Greek firms enjoy in Switzerland similar tax privileges as in Great Britain ... Consequently the grounds supported in contradiction in the petition under consideration should be dismissed as being groundless”.²²

(10) Having cited these three cases it may seem useful, before engaging in the further study of the subject indicated in paragraph 22 of the commentary on article 8, to recapitulate briefly the results hitherto arrived at.

Subject to a further study on the problem of the relation between a most-favoured-nation clause and a customs union or a free trade area and subject also to a further study on the relevance, in that context, of the different levels in the economic development of States, the following conclusions have been reached:

(11) As regards the so-called open multilateral treaties, it has been found that there is no such constant and uniform usage, accepted as law, as would warrant a proposal for a rule excepting open-ended multilateral treaties, i.e. the favours resulting from such treaties, from the operation of most-favoured-nation clauses.

The author of a thorough study of recent vintage, quoted several times in previous reports, has come to the same conclusion:

At present there seems to be no justification in law for saying that a customary usage may exempt open multilateral conventions from the scope of the clause. Neither the material element—the usual practice of States—nor the *opinio juris* affect the issue. At least, the prevailing feeling allows that the question may be approached from various angles, and it is concerned to give due weight to the elements which might lead to an opposing conclusion ...

... As international law stands at present, the only legal solution is to insert a specific exception in the clause, ...²³

²² *Ibid.*, p. 148, para. 87.

²³ E. Sauvignon, *La clause de la nation la plus favorisée* (Grenoble, Presses Universitaires de Grenoble, 1972), pp. 267–268.

²¹ *Ibid.*, p. 142, para. 68.

(12) As regards the so-called closed multilateral treaties it has also been found that the advantages accorded under such treaties do not escape from the operation of a most-favoured-nation clause. The argument has been made that the main reason (although a false one—cf. in this regard E. Allix, quoted in paragraph 17 of the commentary to article 8) for exempting the favours of an open multilateral treaty from the operation of a most-favoured-nation clause is that States can easily acquire the advantages of such treaties by acceding to them. In this way acceding States assume also the obligations arising from the treaty and put themselves in a position of equality with the other parties to the treaty, whereas through the operation of a most-favoured-nation clause they would claim only the advantages of the open multilateral treaty without submitting to its obligations.²⁴ It follows from this reasoning that in the case of a closed multilateral treaty the possibility of an easy accession falls and—*cessante causa cessat effectus*—there remains no reason why the advantages of a closed multilateral treaty should not fall under the operation of a most-favoured-nation clause.

Sauvignon treats this question as one relating to groupings which have not reached the stage of a customs union or a free trade area (*regroupement en-deçà de l'union douanière ou de la zone de libre échange*) and groupings having another object than a customs union or a free trade area (*regroupement ayant un objet autre que l'union douanière ou la zone de libre échange*).²⁵ He examines under these headings the cases ECSC, OEEC (the predecessor of OECD) and the European Convention on Establishment concluded in the framework of the Council of Europe on 13 December 1955. He introduces his analysis with the following words:

... When they [multilateral conventions closed to the accession of third States] establish preferential systems which have not reached the stage of a union or [free trade] area or have another object, the problem of the legal relationship with the most-favoured-nation clause arises again. The beneficiary third States are entitled, in law, to invoke most-favoured-nation treatment. But in practice they may be dissuaded from doing so because such a claim seems politically ill-judged, or because it might prejudice the contractual ties which the claimant has entered into with all the members of the grouping, if the latter decide to react collectively.²⁶

This—it is believed—is a correct evaluation of the situation and an open admission that the operation of the clause extends also to the favours accorded within the multilateral treaties of the type discussed here. It is of course quite another question whether extra-legal considerations, political motives or other factors can or do discourage the beneficiary State from exercising its right.

(13) In his conclusions²⁷ Sauvignon cites an article by Alexandre-Charles Kiss²⁸ in which the learned author develops the following idea: it is generally admitted that

if the granting State and a third State unite into a federal State or even a confederation, the beneficiary of a most-favoured-nation clause loses its rights to the advantages which were accorded by the granting State to the third State before their union took place. Therefore, the author considers—just as it is customary to grant an exception to the operation of a clause to a customs union already in its stage of formation, it would be logical to exempt from the operation of the clause those groupings, the ultimate aim of which is—as e.g. of EEC—to amalgamate the member States into one single State.

(14) Kiss cites also the case of ECSC, against the constituent States of which beneficiary States had not relied upon their clauses. Their reticent attitude was caused—according to Kiss—by the provision of the third paragraph of section 20 of the treaty instituting ECSC,²⁹ which threatens with collective action States wishing to enforce their most-favoured-nation rights. In this connexion he writes:

Clearly we are here leaving the domain of law because the law becomes inapplicable in the actual situation. There is here an incontestable admission that the most-favoured-nation clause is incompatible with the treaties relating to regional groupings and that its application would entail consequences so unacceptable that it is preferable to have recourse to extraordinary measures rather than to accept them.³⁰

To this Sauvignon attaches the following comment:

This opinion must be qualified considerably. It is not certain that the application of the clause to the advantages provided for in close multilateral conventions could always entail unacceptable consequences, and that a new exception to the clause must be introduced. It is, in fact very difficult to establish a criterion for distinguishing between genuine groupings, which seek a permanent consolidation of the ties between the member countries pending the formation of an economic, and subsequently political, union, and *ad hoc* preferences which have no other object than the evasion of the equal treatment rule provided for in the clause. In the latter case, most-favoured-nation treatment constitutes a justified legal obstacle. In the former case, it is incumbent upon the member States to prove the cohesiveness and durability of the grouping by pursuing, with regard to third States benefiting under the clause, an effective collective policy which will deter any attacks on the integrity of the collective régime which has been established.³¹

(15) Kiss concludes his article with the following passage (not quoted by Sauvignon):

It is another question whether, if the occasion arose, a judge, in an endeavour to be fair to all parties, would not consider himself obliged to recognize that it would be desirable for the Government participating in the work of unification to make certain compensatory payments to the third State benefiting under the most-favoured-nation clause.³²

(16) All these passages—it is submitted—support the position taken in article 8 *bis*. The quoted authors see very clearly that *de lege lata* there is no such rule of international law which would except neither open nor closed

²⁴ See para. 17 of the commentary to article 8.

²⁵ Sauvignon, *op. cit.*, pp. 269 *et seq.*

²⁶ *Ibid.*, p. 269.

²⁷ *Ibid.*, p. 277.

²⁸ "La Convention européenne d'établissement et la clause de la nation la plus favorisée", *Annuaire français de droit international*, 1957 (Paris), vol. III, pp. 478–489.

²⁹ See para. 8 of the commentary to article 8.

³⁰ Kiss, *loc. cit.*, p. 486.

³¹ Sauvignon, *op. cit.*, p. 277.

³² Kiss, *loc. cit.*, p. 489.

multilateral treaties from the operation of a most-favoured-nation clause—which is not accompanied by an express proviso to that effect.³³ For the same reason he would also not wish to elaborate on the peculiarities of the so-called “restricted” multilateral treaties. What they do is a search for a solution in cases where the granting State finds itself in a web of its own conflicting treaty obligations. This is, however, a problem which—in the view of the Special Rapporteur — falls beyond the scope of this study.³⁴

III. The case of customs unions and similar associations of States

9. In the following pages an examination will be made of the relation between the most-favoured-nation clause and the advantages granted in the framework of a customs union or other similar associations of States. This seems to be warranted by the fact that customs unions or other such associations of States are not always—though they often are—multilateral. Hence the findings on the relation between the clause and multilateral treaties cannot be automatically applied—at least not to bilateral customs unions. Further, such examination has been promised by the Special Rapporteur³⁵ because of the specificity of such unions and the wealth of problems involved.

10. Before embarking on this study two preliminary clarifications are necessary:

(a) What is understood here under “similar associations of States” besides customs unions is as follows:

- (i) A free trade area;
- (ii) Any interim régime leading to the formation of a customs union or a free trade area; and
- (iii) Any other association or grouping of States which is based upon a customs union, a free trade area, or an interim régime leading or intended to lead to a customs union or a free trade area.

(b) Whenever reference is made to a customs union or free trade area below, all other types of the associations mentioned above are also to be understood. It follows from what is indicated under (a) above that the type of most-favoured-nation clause which is borne in mind for the present purposes is one which covers or is restricted to benefits in respect of customs duties and other matters related to trade.

11. The agreement reproduced below illustrates the problems to be discussed:

³³ Because the result is the same in regard to both “open” and “closed” multilateral treaties, the Special Rapporteur does not propose to engage in an analysis of these two expressions or to examine the wide spectrum of the “grey” area obviously lying between these two extremes.

³⁴ Further proposals concerning articles 6 *quater*, 7 *bis*, 15 and 16 will be made later.

³⁵ See *Yearbook... 1973*, vol. II, pp. 115–116, document A/CN.4/266, para. 22 of the commentary to article 8.

TRADE AGREEMENT BETWEEN THE GOVERNMENT OF THE UNION OF SOVIET SOCIALIST REPUBLICS AND THE GOVERNMENT OF THE COMMONWEALTH OF AUSTRALIA. SIGNED AT MOSCOW, ON 15 OCTOBER 1965

The Government of the Union of Soviet Socialist Republics and the Government of the Commonwealth of Australia,

Desiring to develop trade between their two countries to their mutual benefit,

Have agreed as follows:

Article 1

1. The Contracting Parties shall accord each other unconditional most-favoured-nation treatment in all matters with respect to customs duties and charges of any kind imposed on or in connection with importation or exportation of products and with respect to the method of levying such duties and charges, with respect to all rules and formalities connected with importation or exportation, and with respect to all internal taxes or other internal charges of any kind.

2. Accordingly, products of the territory of one of the Contracting Parties imported into the territory of the other Contracting Party shall not be subject, in regard to the matters referred to in paragraph 1 of this Article, to any other or higher duties, taxes or charges, or to any rules or formalities more burdensome, than those to which the like products of any third country are or may hereafter be subject.

3. Similarly, products exported from the territory of one of the Contracting Parties and consigned to the territory of the other Contracting Party shall not be subject, in regard to the matters referred to in paragraph 1 of this Article, to any other or higher duties, taxes or charges, or to any rules or formalities more burdensome, than those to which the like products when consigned to the territory of any third country are or may hereafter be subject.

4. Any advantage, favour, privilege or immunity which has been or may hereafter be granted by either Contracting Party in regard to the matters referred to in paragraph 1 of this Article to any product originating in or consigned to any third country shall be immediately and unconditionally accorded to the like product originating in or consigned to the territory of the other Contracting Party.

Article 2

1. No prohibitions or restrictions, whether in the form of quotas, import or export licences, foreign exchange controls, regulations, directives or any other measures, shall be instituted or maintained by either Contracting Party on the importation of any product from the territory of the other Contracting Party or on the exportation of any product consigned to the territory of the other Contracting Party, unless such prohibitions or restrictions are applicable to all third countries.

2. The provisions of paragraph 1 of this Article shall not apply to import or exchange prohibitions or restrictions applicable to all countries in like circumstances for the purpose of safeguarding the external financial position and balance of payments.

Article 3

The provisions of this Agreement shall not limit the right of either Contracting Party to apply prohibitions or restrictions of any kind which are directed:

(a) to the protection of its essential security interests; or

(b) to the protection of public health or the prevention of diseases and pests in animals or plants.

Article 4

All payments arising from trade between the two countries shall be effected in convertible currency.

Article 5

The provisions of Articles 1 and 2 of this Agreement shall not apply to:

(a) preferences or advantages accorded by the Union of Soviet Socialist Republics to countries immediately adjacent to the Union of Soviet Socialist Republics;

(b) preferences or advantages, accorded by the Commonwealth of Australia within the framework of the Commonwealth of Nations or to Ireland.

Article 6

The Contracting Parties agree to consult together at any time, at the request of either, on any matter affecting the operation of this Agreement.

Article 7

This Agreement shall come into force on the day of its signature and shall remain in force for a period of four years from that day. Thereafter it shall remain in force until the expiration of ninety days from the date on which one of the Contracting Parties receives from the other Contracting Party written notice of its intention to terminate it.

IN WITNESS WHEREOF, the undersigned, being duly authorised by their respective Governments, have signed this Agreement.³⁶

12. As will be seen from articles 3 and 5, the agreement contains exceptions to the most-favoured-nation clause, but no exception concerning a customs union or a free-trade area. It is interesting to note in this connexion that the most-favoured-nation clauses contained in a trade agreement between the Government of the Republic of the Philippines and the Government of the Commonwealth of Australia, which was signed at Manila, on 16 June 1965 and entered into force on that date, contains numerous exceptions to the clause including explicitly the association of one of the parties in a customs union or a free trade area.

The exception clause of this agreement reads as follows:

Article V

The provisions of Articles III and IV of this Agreement shall not apply to:

(a) tariff preferences or other advantages accorded at present by the Republic of the Philippines to the United States of America;

(b) tariff preferences or other advantages accorded by the Commonwealth of Australia to its external territories or to any country at present a member of the Commonwealth of Nations, including its external territories or to Ireland;

(c) tariff preferences or other advantages accorded by either Government to any third country which are not inconsistent with the General Agreement on Tariffs and Trade or which conform to

any international agreement concluded under the auspices of the United Nations, including preferences and advantages resulting from the association of one of the parties in a customs union or free trade area;

(d) such measures as either Government may consider necessary to safeguard its external financial position and balance of payments;

(e) such measures either Government may take to carry out its obligations under any multilateral commodity agreement which is open to participation by the parties to this Agreement.³⁷

13. As seen from the two examples given above, there are clauses which contain and others which do not contain an explicit exception concerning advantages granted within a customs union or a free trade area. The question, therefore, arises, how to interpret a most-favoured-nation clause which does not contain such an explicit exception?

14. According to the general rule of interpretation embodied in the Vienna Convention on the Law of Treaties³⁸ a most-favoured-nation clause, like any other treaty provision, has to be interpreted "in good faith, in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose" (art. 31, para. 1). However, "there shall be taken into account, together with the context . . . any relevant rules of international law applicable in the relations between the parties" (art. 31, para. 3(c)).

15. Are there relevant rules of international law which would provide for an implied exception concerning customs unions and free trade areas in every most-favoured-nation stipulation concerning customs duties and other related matters? In other words and in a somewhat detailed manner: is it possible "to discern in . . . [the practice of States] any constant and uniform usage"³⁹ exempting favours granted within a customs union or a free trade area from the operation of a most-favoured-nation clause which obliges the grantor State vis-à-vis an outsider beneficiary State? If the answer is in the affirmative, is this usage coupled with a *communis opinio juris* which raises such usage to the level of a rule of customary international law?

16. In the event that one or both of these elements are lacking and no rule of customary law can be established for the purpose of codification, is it desirable, and on what grounds, that the Commission propose the adoption of a rule of the kind as a progressive development of international law and how should such a rule be formulated?

An exercise of this kind is of course carried out by the Commission before the adoption of every draft rule. This logical process is inherent in every work of codification and progressive development. The special emphasis laid upon it here does not detract from its relevance in all other spheres of this and other similar studies.

³⁷ *Ibid.*, vol. 541, p. 34.

³⁸ For the text of the Convention, see *Official Records of the United Nations Conference on the Law of Treaties, Documents of the Conference* (United Nations publication, Sales No. E.70.V.5), p. 289.

³⁹ *Asylum case (Colombia/Peru), Judgement of November 20th 1950. ICJ Reports, 1950, p. 277.*

³⁶ United Nations, *Treaty Series*, vol. 563, pp. 241, 243 and 245.

Definitions

17. According to the Permanent Court of International Justice, the requirements of a customs union are as follows: "uniformity of customs law and customs tariff; unity of the customs frontiers and of the customs territory vis-à-vis third States; freedom from import and export duties in the exchange of goods between the partner States; apportionment of the duties collected according to a fixed quota".⁴⁰

18. While the definition of the Court was intended to be of a general validity, that embodied in GATT serves only the purpose of that agreement, and it is also quite different. According to article XXIV, paragraph 8 of GATT:

(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

- (i) duties and other restrictive regulations of commerce (except where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,
- (ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;

(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.⁴¹

19. Other parts of article XXIV, however, contain further conditions which have to be fulfilled in order that a customs union or a free-trade area meet the requirements that are necessary for constituting a full-fledged exception to the most-favoured-nation clause of the Agreement. Most of these provisions were quoted in the Special Rapporteur's second report⁴² and are reproduced here for the sake of convenience as follows:

...

4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided that* :

(a) with respect to a customs union, or an interim agreement leading to the formation of a customs union, the duties and other

regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;

(b) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement, as the case may be; and

(c) any interim agreement referred to in subparagraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

6. If, in fulfilling the requirements of subparagraph 5 (a), a contracting party proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reductions brought about in the corresponding duty of the other constituents of the union.

7. (a) Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the CONTRACTING PARTIES and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

(b) If, after having studied the plan and schedule included in an interim agreement referred to in paragraph 5 in consultation with the parties to that agreement and taking due account of the information made available in accordance with the provisions of subparagraph (a), the CONTRACTING PARTIES find that such agreement is not likely to result in the formation of a customs union or of a free-trade area within the period contemplated by the parties to the agreement or that such period is not a reasonable one, the CONTRACTING PARTIES shall make recommendations to the parties to the agreement. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.

(c) Any substantial change in the plan or schedule referred to in paragraph 5(c) shall be communicated to the CONTRACTING PARTIES, which may request the contracting parties concerned to consult with them if the change seems likely to jeopardize or delay unduly the formation of the customs union or of the free-trade area.⁴³

20. As we are reminded by Jackson, article XXIV grants

an exception to GATT obligations for three types of regional arrangements: (1) A customs union, (2) a free trade area and (3) an "interim agreement" leading to the formation of either a customs union or free-trade area. The expressed rationale behind this exception is the recognition stated in Article XXIV, paragraph 4 that regional arrangements can "increase freedom of trade" through "closer integration between economies". ... the danger of "raising barriers to the trade of other contracting parties" is also recognized.⁴⁴

⁴⁰ Customs régime between Germany and Austria, Protocol of 19 March 1931, Advisory Opinion of 5 September 1931, *P.C.I.J.*, Series A/B, No. 41, p. 51.

⁴¹ GATT, *Basic Instruments and Selected Documents*, vol. IV, (Sales No. GATT/1969-1), p. 43.

⁴² *Yearbook... 1970*, vol. II, p. 226, document A/CN.4/228 and Add.1, para. 167.

⁴³ GATT, *Basic Instruments and Selected Documents*, vol. IV (*op. cit.*), pp. 41-43.

⁴⁴ Jackson, *op. cit.*, p. 581.

However, nothing is said against barriers to the trade of non-parties.

21. The philosophy of article XXIV is that if the particular legal requirements and prerequisites of one of the three arrangements mentioned are fulfilled, then the exception to GATT obligations (to the most-favoured-nation clause) is automatic—no special action is required by GATT.⁴⁵ According to paragraph 10 of article XXIV, exceptional cases may be approved by the Contracting Parties by a two-thirds majority.

22. For the purpose of the present report, it is of special interest that the terms of paragraph 5 of article XXIV, which establishes the exception, apply only to regional arrangements between territories of contracting parties; thus, if a non-party to GATT belongs to the customs union, free-trade area or interim agreement in question, the arrangement is not eligible for the “automatic exception” in GATT.⁴⁶

23. It is impossible in the context of this report to deal in detail with all the difficulties entailed by the interpretation and application of the provisions of article XXIV. Innumerable GATT documents and a vast literature have analysed in one way or another these provisions.⁴⁷

Suffice it here to indicate briefly some of the most controversial problems:

What are the criteria for “trade creation” and “trade diversion” as these terms are understood to express tersely the idea of paragraph 4?

What is the meaning of the following expressions: “... shall not on the whole be higher or more restrictive ...” (para. 5(a)); “... general incidence of the duties and regulations of commerce applicable ...” (para. 5(a)); “... a plan and schedule ...” (para. 5(c)); “... reasonable length of time ...” (para. 5(c)); “... substantially all the trade ...” (para. 8(a) (i)), etc.?

24. Some remarks on these and other problems in connexion with article XXIV were quoted in the Special Rapporteur’s second report.⁴⁸ The reader is respectfully referred to these paragraphs. Paragraph 171 deserves to be quoted *in extenso*:

Not a single customs union or free-trade area agreement which has been submitted to the Contracting Parties has conformed fully to the requirements of article XXIV. Yet, the Contracting Parties have felt compelled to grant waivers of one kind or another for every one of the proposed agreements.⁴⁹ The Contracting Parties have not been able to say whether the major schemes examined by them qualified as customs unions or free-trade areas under the GATT rules. The formal action in the case of the European Economic Community was to lay aside “for the time being” questions of law and the compatibility of the Treaty with the General Agreement.

⁴⁵ *Ibid.*, pp. 581–582. See also the numerous documentary sources cited by Jackson.

⁴⁶ *Ibid.*, p. 582.

⁴⁷ Jackson, *op. cit.*; T. Flory, *Le GATT, droit international et commerce mondial* (Paris, Librairie générale de droit et de jurisprudence, 1968); K.W. Dam, *The GATT, Law and International Economic Organization* (Chicago, University of Chicago Press, 1970), etc.

⁴⁸ *Yearbook... 1970*, vol. II, p. 227, document A/CN.4/228 and Add.1, paras. 169–170.

In the case of the European Free Trade Association and the Latin American Free Trade Area it was concluded that the legal question could not be “fruitfully discussed further at this stage” and that “at this juncture” it would not be “appropriate to make any formal legal findings”.^{48a}

¹⁸³ K.W. Dam, [“Regional economic arrangements and the GATT: The legacy of a misconception”, in *The University of Chicago Law Review*, vol. 30, No. 4 (Summer 1963)], pp. 660–661.

¹⁸⁴ G. Patterson, [Discrimination in International Trade: The Policy Issues, 1945–1965 (Princeton, N.J., Princeton University Press, 1966)], pp. 157–158. For further details on these cases, see G.P. Verbit, “Preferences and the Public Law of International Trade: The End of Most-Favoured-Nation Treatment?” in *Hague Academy of International Law, Colloquium 1968: International Trade Agreements* (Leiden, Sijthoff, 1969) pp. 48–49.

The practice of States

25. States parties to a treaty granting most-favoured-nation rights are by virtue of their sovereignty free to a limitation of such rights. They can and generally do limit the clause to certain fields (trade, customs duties, consular rights etc.) and can—and very often do—exclude from the operation of the clause certain advantages accorded to specified third States or in specific contexts, or maintain their freedom to withhold most-favoured-nation rights in definite circumstances.⁴⁹

26. Stipulations excluding the concessions accorded within customs unions or similar associations of States are frequent. Snyder, who analysed the economic treaties concluded between the two world wars found 280 customs union exception clauses in that period. He states that

the Treaty of Rapallo is indicative of the general type of provision covering this matter: it excludes from the normal operation of the most-favoured-nation clause “favours granted by one of the contracting parties to a third State on account of a customs union already established or to be established”. Occasionally, “economic union” or “economic understanding” is apparently substituted for customs union, even though they are not necessarily identical.⁵⁰

27. This situation has not changed in essence since the Second World War. It is believed that a majority of trade agreements, i.e. those dealing with customs tariffs and related matters contain an explicit customs union exception to the most-favoured-nation clause. Such provisions show an infinite variety. Some further examples are given below:

TRADE AGREEMENT BETWEEN THE UNION OF SOVIET SOCIALIST REPUBLICS AND THE REPUBLIC OF DAHOMEY. SIGNED AT PORTO-NOVO, ON 10 JULY 1963

Article I

The provisions of this article shall not apply to

...

(c) Advantages resulting from agreements concerning a customs union which have been or may hereafter be concluded by either Contracting Party.⁵¹

⁴⁹ See, e.g. arts. 3 and 5 of the Australia-USSR agreement or art. V of the Australia-Philippines agreement, quoted in paras. 11 and 12 above.

⁵⁰ R.C. Snyder, *The Most-Favoured Clause: An Analysis with Particular Reference to Recent Treaty Practice and Tariffs* (New York, King’s Crown Press, Columbia University, 1948), p. 160.

⁵¹ United Nations, *Treaty Series*, vol. 528, p. 176.

TRADE AGREEMENT BETWEEN THE GOVERNMENT OF GREECE AND THE GOVERNMENT OF PAKISTAN. SIGNED AT ATHENS, ON 17 JANUARY 1963

Article IV

The advantages set out in Article III above of this agreement shall not apply to:

- (i) Preferences which either of the two countries grants to facilitate frontier traffic;
- (ii) Advantages resulting from a customs union which either of the two Contracting Parties had previously concluded or shall conclude, or resulting from a free exchange system as in the cases of the Free Trade Area;
- (iii) Preferences and advantages permitted by GATT, particularly those covered by Article I and paragraph II of Article XXIV of GATT.⁵²

TREATY OF COMMERCE, ESTABLISHMENT AND NAVIGATION BETWEEN THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND AND JAPAN. SIGNED AT LONDON ON 14 NOVEMBER 1962

Article 29

...

3. The provisions of the present Treaty relative to the grant of treatment not less favourable than that accorded to any other foreign country shall not be construed so as to oblige one Contracting Party to extend to the other the benefit of any treatment, preference or privilege which may be extended by the former Contracting Party by virtue of:

- (a) the formation of a customs union or a free trade area, or
- (b) the adoption of an agreement designed to lead to the formation of such union or area within a reasonable length of time.⁵³

The most notable customs union exception clause is obviously article XXIV of GATT, the text of which has been reproduced above.⁵⁴

28. There is no doubt about the fact that it is a very frequent practice of States to except from their most-favoured-nation rights and obligations benefits granted by virtue of a customs union, a free trade area or other associations. As to customs unions, this is not a new phenomenon.

The League of Nations Economic Committee

29. In the Special Rapporteur's first report, the following passage from a League of Nations paper entitled "Recommendations of the Economic Committee relating to tariff policy and the most-favoured-nation clause", dated 16 February 1933, was quoted:

The most-favoured-nation clause frequently includes a provision allowing for the possibility of each of the parties concluding a complete customs union with a third power. In such a case, the economic unit becomes in practice something different from the political unit, and the customs union may be regarded rather as the abolition of a customs frontier than as a form of discrimination between competing foreign purveyors.

In such cases, the exception to the most-favoured-nation clause takes the form of a reservation covering the privileges accorded to a third power in virtue of a customs union which has been or may hereafter be concluded. The clause may be drawn up in different ways, but the variations do not involve substantial differences. It appears in a large number of treaties.

... it is sufficient to declare that customs unions constitute exceptions, recognised by tradition, to the principle of most-favoured-nation treatment.⁵⁵

30. The reference to a "recognised tradition" of the customs union exception—as is evident from the context—clearly points to the traditional insertion of such an exception into clauses on customs matters. The Economic Committee clearly intended to encourage the continuance of this "tradition" as under the heading "Wording of the clause" it recommended a text for clauses on customs matters with the inclusion of the following passage:

Nevertheless, the advantages now accorded or which hereafter be accorded to other adjacent countries in order to facilitate frontier traffic, and advantages resulting from a Customs union already concluded or hereafter to be concluded by either Contracting Party, shall be excepted from the operation of this article.⁵⁶

The 1936 resolution of the Institute of International Law

31. It was the frequency of stipulation of customs unions exceptions which lead B. Nolde to far-fetched conclusions. In his report to the Institute of International Law he cites the passage from the text of the model clause recommended by the League Economic Committee quoted above and continues as follows:

The two cases envisaged in this reservation—frontier traffic and customs unions—are very different, but it is equally evident it could never be considered that either of the special customs régimes to which they refer could be acquired by virtue of the most-favoured-nation clause. Moreover, trade conventions which go into any detail at all always contain these two reservations, and we may consider them as belonging to general international law.⁵⁷

And further:

In fact, it has never been disputed that customs unions do not require any privilege to be granted by virtue of the clause. A very great number of trade treaties state this explicitly, and those which do not do so must be interpreted in this way.⁵⁸

32. The complete indifference of the distinguished rapporteur in 1934 towards quite recent events and to the conduct of important States is, indeed, astonishing and so is the remarkable ease with which the Institute followed the proposal of its rapporteur. The relevant text of the resolution adopted by the Institute at its Brussels session in 1936 on the effects of the most-favoured-nation clause in matters of commerce and navigation reads as follows:

⁵⁵ *Yearbook... 1969*, vol. II, p. 179, document A/CN.4/213, annex I.

⁵⁶ *Ibid.*

⁵⁷ *Annuaire de l'Institut de Droit International, 1934* (Brussels), vol. 38, pp. 452-453.

⁵⁸ *Ibid.*, pp. 453-454.

⁵² *Ibid.*, vol. 538, p. 178.

⁵³ *Ibid.*, vol. 478, pp. 120 and 122.

⁵⁴ See above, paras. 18 *et seq.*

Paragraph 7

The most-favoured-nation clause does not confer the right:

...

to the treatment resulting from a Customs union which has been or may hereafter be concluded; ...⁵⁹

Official views on an alleged implied exception

33. Among the events and the attitudes of States which the Institute could have taken into account was the notable affair of the customs régime between Austria and Germany which came up before the Council of the League of Nations in 1931 and the official pronouncements of several States to which this case has given rise.

34. The Solicitor for the Department of State of the United States of America expressed the view that the establishment of a customs union between Austria and Germany would not constitute an exception to the most-favoured-nation provisions in the treaty of friendship, commerce, and consular rights of 8 December 1923 with Germany⁶⁰ and of 19 June 1928 with Austria.⁶¹

He stated:

It must be apparent that this Government, at the time of the conclusion of commercial treaties with Germany and Austria, never contemplated that a customs union would be an implied exception to the most-favoured-nation clause, particularly since certain specific exceptions to the clause were expressly stated. Nor can this Government be held to any recognition of such an exception as a principle of international law. This Government has never taken cognizance of the alleged continental tradition of customs unions as implied exceptions; indeed, it is doubtful if such a tradition was ever recognized by other than a few nations. International law does not find its present growth in the traditional habits of continental nations alone... Seemingly the exponents of this idea content themselves with the citation of treaties in which specific exception has been made. It might follow that the specific inclusion of the exception is the tradition and that this established procedure reflects the true legal nature thereof.

The logical conclusion, therefore, would seem to be that, since certain exceptions to the most-favoured-nation provisions were made in the treaties [concluded by the U.S.] with Germany and Austria and such exceptions do not include customs unions, we would be entitled to claim from Germany whatever advantages she may extend to Austrian trade and commerce, and to claim from Austria whatever advantages may be extended by that country to trade and commerce with Germany.

The fact that the contracting parties undertook to make exceptions to the obligation to extend unconditional most-favoured-nation treatment in customs matters and made no exception with respect to a possible customs union would seem to preclude the possibility of regarding such an arrangement as an exception to the most-favoured-nation provisions on the basis of the principle *inclusio unius exclusio alterius*.⁶²

35. The position taken by France was very similar to that of the United States. According to the French memorandum of 14 May 1931 submitted to the Council of the League:

⁵⁹ For the full text of the resolution see *Yearbook... 1969*, vol. II, pp. 180-181, document A/CN.4/213, Annex II.

⁶⁰ League of Nations, *Treaty Series*, vol. LII, p. 133.

⁶¹ *Ibid.*, vol. CXVIII, p. 241.

⁶² G. H. Hackworth, *Digest of International Law*, vol. V (Washington, D. C., U.S. Government Printing Office, 1943), pp. 295-196.

... The fact that certain Powers did not include an exception relating to customs unions in the treaties based on the most-favoured-nation treatment which they concluded with Austria and Germany would give these Powers "the strongest legal grounds for claiming in the present circumstances the full benefit of most-favoured-nation treatment".

The memorandum adds: It would be purposeless to refute this argument by relying on the "Recommendations relating to commercial policy" which the Economic Committee of the League of Nations addressed to the Council in 1929, in which it is said that: "Customs unions constitute exceptions, recognized by tradition, to the principle of most-favoured-nation treatment". But the report immediately adds: "But [the Committee] does not propose to offer an opinion on the more controversial topic of their formation". This constitutes a recognition by the Economic Committee that any customs union that may be formed would give rise from the outset to political or economic objections, sometimes fundamental, on the part of third States. As an example there might be quoted the intervention of Austria-Hungary in 1905 based on the most-favoured-nation treatment which caused a proposed customs union between Bulgaria and Serbia to fail.⁶³

Sauvignon quoting the above passages, adds:

It appears from this memorandum that France, at that moment, reserved the right to use the clause to justify in law its possible political or economic opposition to a customs union. In other words, France did not intend to be legally bound by any contrary customary usage.⁶⁴

The Ouchy Convention 1932

36. This is again an instance which throws some light on the practice of States in the interwar period. According to J. Viner:

... Under this Convention, negotiated at Ouchy but signed at Geneva, July 18 1932, by Belgium, Luxembourg, and the Netherlands, the parties agreed that there should be no increases in existing duties or application of new duties on imports from each other; that no new duties on imports from other countries with which there were treaty relations should be levied unless those states had previously raised their own trade barriers; that existing duties on imports from each other should be reduced by 10 per cent per annum until the total reduction reached 50 per cent; that there should be no new barriers other than import duties on imports from each other; and that there should be open entry to the convention on the part of other countries and extension of its benefits to non-entering countries if they in fact carried out its terms.

Of all the serious projects up to that time for collective tariff agreements, it went furthest in the direction of a genuine lowering of trade barriers. Belgium and the Netherlands, however, both had commercial treaties containing the most-favoured-nation clause with the United Kingdom and other countries, and the Ouchy Convention provided that it should not come into effect until such countries had waived their rights. Great Britain refused to waive its rights; the Ottawa Conference held in the same year passed a resolution declaring that regional agreements could not be allowed to override most-favoured-nation obligations; and the United States made no reply to the request for a waiver. The convention, in consequence, lapsed without ever coming into operation.⁶⁵

⁶³ Cited by Sauvignon, *op. cit.*, p. 239. For the text of the French memorandum, see League of Nations, *Official Journal*, 12th Year, No. 7 (July 1931), p. 1167.

⁶⁴ Sauvignon, *op. cit.*, p. 239.

⁶⁵ J. Viner, *The Customs Union Issue* (Studies in the administration of international law and organization, No. 10 (New York, Carnegie Endowment for International Peace, 1950)), pp. 30-31.

The Hague Convention of 1937

37. Also according to J. Viner, this Convention was signed on

... May 28, 1937. The participating countries were the Ouchy Convention countries plus Norway, Sweden, Denmark, and Finland. The Hague convention provided for specified "bindings" of tariff rates, and for removals of specified existing quantitative restrictions on imports from participating countries and undertakings not to introduce new ones on commodities not already subject to them. All non-participating states were declared eligible to adhere to the convention in conformity with terms to be negotiated between them and the countries already parties thereto. It is to be noted that the convention did not provide for reductions, preferential or otherwise, of ordinary import duties, and it was presumably on the strength of this that the participating countries hoped that it would surmount the obstacle of the most-favoured-nation clause.

The Hague convention came into actual operation, but the Netherlands declined to renew it at the end of its first year of operation, and the other parties to it thereupon allowed it to lapse. The explanation offered by the Netherlands for its failure to renew its participation in the convention was that other countries, and especially the United Kingdom, had insisted that most-favoured-nation obligations applied to quotas as well as to tariffs, that economic conditions had changed for the worse since the conclusion of the convention, which made its requirements irksome, and that the expected adherence of additional countries had not occurred.⁶⁶

Attitude of the USSR

38. Under this heading, a study prepared by the League of Nations Secretariat, but published after the dissolution of that Secretariat by the United Nations in 1947 outlines the Soviet position in the period under consideration as follows:

If concrete evidence of the Soviet Union's attitude towards regional exceptions to m.f.n. is meagre because of the rarity and peculiar nature of her treaties, there is no doubt that she has been opposed to admitting such exceptions. She has been categorical in her insistence on the fullest possible interpretation of the m.f.n. clause and there appear to be no instances of Soviet acceptance of a regional exception.

... the USSR raised objections to the preferential agreements negotiated by Germany with certain Danubian countries in 1931. Evidence of her opposition to any "discrimination" is provided in the 1931 discussions in the European Commission on her proposed Economic Non-aggression Pact. Discussion arose on the relation between the principle of non-discrimination and the exceptions to the m.f.n. clause sanctioned by practice (frontier traffic, customs unions, regional clauses, etc.). The Soviet view was that non-discrimination tended to forbid the creation of a commercial and financial régime which would be inflicted on a given country or on a small group of countries when the commercial and financial policy of the country establishing this régime was distinctly more favourable to other countries. To quote the report of the Special Committee set up to examine the Soviet proposal:

"By this declaration, the Soviet delegation considered that it had implicitly replied to a series of questions put by certain delegates in regard to the relation existing between the principle of non-discrimination and the exceptions to the most-favoured-nation clause sanctioned by practice, such as those relating to frontier traffic, customs unions, regional clauses, etc."

As regards the question of how the pact would affect possible preferential agreements, the Soviet delegation considered that these

agreements would only be in contradiction with the draft if they were concluded without the consent of the parties entitled under their commercial treaties to claim the same advantage.⁶⁷

A conclusion with regard to the pre-Second World War period

39. The material presented above leads the Special Rapporteur, and, it is to be hoped, the reader, to the same conclusion which has been reached by Vignes: "... in fact, up to the war of 1939-1945, there was really no consistent practice of States with regard to the granting of full legal status to the (customs union) exception ...".⁶⁸

This realistic evaluation of the situation existing during the period in question can obviously be extended to free trade areas, interim régimes and other groupings of States in regard to which there has also not developed, to say the least, a constant and uniform practice as to their exception—without an explicit provision to that effect—from the operation of a most-favoured-nation clause. The learned author, however, continues his sentence as follows: "... the most recent practice seems to show that customs unions are now unquestionably considered to be an exception". This part of Vignes' statement will be examined in the following paragraphs.

Recent developments

A. De lege lata

40. The view of Vignes is not isolated. Several other authors hold the same or similar view. It is intended here to review their arguments. The purpose of the exercise is, let the reader be reminded, to find out whether it is possible to establish a generally recognized custom to the effect that the beneficiary of a most-favoured-nation clause relating to trade in general and customs and other related matters in particular, (here it is dealt always with this type of clause only) cannot claim from the granting State favours which the latter accords to his partner within a customs union, a free trade area, an interim régime or another closed or open grouping of States, even if the clause—or the treaty embodying it—is silent on such eventualities. For the sake of brevity the question may be put in the following form: is there a rule of international law establishing to clauses of the type mentioned an implied customs union exception? (When speaking of customs unions, it is meant for the present purposes the other types of grouping also.)

41. To begin, the following statement may be made: the presumption obviously militates against such an exception. If States promise each other most-favoured-nation treatment, they are supposed to carry out their promise. They

⁶⁷ *Customs Unions, A League of Nations Contribution to the Study of Customs Union Problems* (United Nations Publication, Sales No. 1948.II.D.3), p. 58.

⁶⁸ D. Vignes, "La clause de la nation la plus favorisée et sa pratique contemporaine", *Recueil des cours de l'Académie de droit international de La Haye, 1970-II* (Leiden, Sijthoff, 1971), vol. 130, p. 278.

⁶⁶ *Ibid.*, pp. 31-32.

may limit such promise, but if they do not, they have to bear the consequences. To put it in another way:

As a matter of general principle, it should not be possible to imply exceptions to the most-favoured-nation clause, regardless of whether such an exception would be in favour of a customs union, a region or an economic union. The reason is, of course, that bargained-for advantages should not be denied a treaty partner because of the unilateral action of the other. The failure to stipulate the exception expressly, however, would make such a denial on the basis of implied exceptions nothing short of unilateral action.⁶⁹

42. What arguments can be and are put forward for the purpose of rebutting the presumption? They can be dealt with one by one.

43. (A) "It should be noted first of all that there are many treaties (the majority of trade treaties) which contain a provision exempting customs unions from the scope of the clause" writes Sauvignon, himself taking a stand for the implied exception. He adds, however: "Compared with the positions formerly taken by the major trading Powers, these explicit reservations can give the impression that the international community sets aside any customary usage in the matter".⁷⁰ Although he later on argues against it, this latter conclusion seems to the Special Rapporteur more convincing.

44. (B) Sauvignon writes further:

In reality there are two arguments which support the view that the frequency of the exclusion of customs unions amounts to a practice recognized as lawful and that a customary usage therefore exists.

The first argument is that the authors who adduce the diplomatic practice of the major States and demonstrate the reservations of those States with regard to customs unions (McNair, Hackworth, Kiss) generally base their opinion on old documents, clearly pre-dating the Second World War.⁷¹

This argument cannot be taken too seriously. What we are interested in is the practice of States and their *communis opinio*. And as to modern practice, the situation is not always that the small States form customs unions and the big Powers insist upon their most-favoured-nation rights, but often the opposite. In Europe, e.g. some smaller States complain about the infringement of their most-favoured-nation rights by the groupings of more powerful ones.

45. (C) The next argument relies upon article XXIV of GATT. Sauvignon writes:

GATT was established in 1947, and that is the second argument. Article XXIV of the General Agreement exempts customs unions from the scope of the clause. Eighty States have thus confirmed the exception, which the majority of them already recognized in their bilateral agreements. It is difficult not to see in this consensus a recognition on the part of the international community of the necessity and mandatory character of the exception.⁷²

⁶⁹ P. Hay, "European Common Market and the most-favoured-nation clause," *University of Pittsburgh Law Review*, vol. 23 (1962) p. 679.

⁷⁰ Sauvignon, *op. cit.*, p. 241.

⁷¹ *Ibid.*

⁷² *Ibid.*, pp. 241-242.

Vignes follows the same line of thought:

We must recognize the support which this argument [i.e. the implied customs union exception] obtained with the signing of the General Agreement and thus with its recognition by the 95 States participating *de jure* or *de facto* in the General Agreement.⁷³

46. For the Special Rapporteur, it is difficult to agree with this type of reasoning. The General Agreement, however important, is one agreement among many. The parties to this Agreement conceded to each other certain most-favoured-nation rights and stipulated certain exceptions, as that of article XXIV, which is a rather complicated arrangement. Can one infer from this fact that the parties to this Agreement when they conclude treaties with non-parties containing the most-favoured-nation clause have to be considered as bound by the terms of article XXIV in relation to their treaty partners and vice versa? And what about the treaties of a State which under article XXXI of GATT withdrew from the Agreement, treaties concluded after the withdrawal? And what about treaties between two or more non-parties to GATT? How will they be bound by the terms of a treaty which is for them *res inter alios acta*? Or does GATT possess such a "radiation effect" which would impose upon non-parties the rule of article XXIV, as one which passed into the general *corpus* of international law on its acceptance by a *communis opinio iuris*?⁷⁴

47. (D) Another argument considers a customs union as a new entity and perhaps a new subject of international law.⁷⁵ If the association of States into such unions could be assimilated to a uniting of States, the argument goes, then most-favoured-nation rights based on favours accorded by one member of the union to the other could not be claimed by an outsider after the establishment of the union.

48. Since the States participating in such unions usually continued as independent and sovereign States, this view is difficult to accept. The International Law Commission, when preparing the draft articles on succession of States in respect of treaties made it plain that associations of States having the character of international organizations such as, for example, the United Nations, etc., could not be considered a uniting of States and the same applied to hybrid unions which might appear to have some analogy with a uniting of States but did not result in a new State.⁷⁶

The Commission, having cited the example of EEC, which—at least from the point of view of succession in respect of treaties—appeared to the Commission to keep on the plane of intergovernmental organizations, went on to say:

Thus, article 234 of the Treaty of Rome⁷⁷ unmistakably approaches the question of the pre-Community treaties of member States with third countries from the angle of the rules governing the

⁷³ Vignes, *loc. cit.*, p. 278.

⁷⁴ See para. 52 below.

⁷⁵ Hay, *loc. cit.*, p. 680.

⁷⁶ See *Yearbook... 1974*, vol. II (Part One), p. 253, document A/9610/Rev.1, para. 3 of the commentary to articles 30, 31 and 32.

⁷⁷ For the text of the article, see *Yearbook... 1973*, vol. II, p. 109, document A/CN.4/266, para. 9 of the commentary to article 8.

application of successive treaties relating to the same subject matter (article 30 of the Vienna Convention) on the Law of Treaties. In other words, pre-Community treaties are dealt with in the Rome Treaty in the context of the compatibility of treaty obligations and not of the succession of States. The same is true of the instruments which established the other European Communities.⁷⁸ Furthermore, the Treaty of Accession of 22 January 1972,⁷⁹ which sets out the conditions under which four additional States may join EEC and EURATOM, deals with the pre-accession treaties of the candidate States on the basis of compatibility of treaty obligations—of requiring them to bring their existing treaty obligations into line with the obligations arising from their accession to the Communities. Similarly, the Treaty of Accession expressly provides for the new member States to become bound by various categories of pre-accession treaties concluded by the Communities or by their original members and does not rely on the operation of any principle of succession.

Numerous other economic unions have been created in various forms and with varying degrees of "community" machinery; e.g. EFTA, LAFTA and other free-trade areas and the Benelux. In general, the constitutions of these economic unions leave in no doubt their essential character as intergovernmental organizations. In the case of the Belgium-Luxembourg Economic Union, if Belgium may be expressly empowered to conclude treaties on behalf of the Union, the relationship between the two countries within the Union appears to remain definitively on the international plane. In practice all these economic unions, including the closely integrated Liechtenstein-Swiss Customs Union, have been treated as international unions and not as involving the creation of a new State.⁸⁰

49. This chain of reasoning leads to the conclusion that an economic association or "integration" of States, however close, but falling short of a uniting of States, does not by itself terminate previously existing agreements of participants in general and their most-favoured-nation obligations in particular. An argument admitting the continued existence of treaties but claiming that the formation of a new entity excepts certain areas from the application of those treaties is equally lacking in justification.⁸¹

50. (E) An argument closely related to the former refers to the changed circumstances created by the formation of a customs union or another type of association of States. Here again it seems untenable to maintain that, in the absence of a political union among the participants, the changed circumstances of one of the parties should justify a modification by implication. This follows from the general rule that any recognition of the effect of changed circumstances requires more than a voluntary and

unilateral change of circumstances by one of the treaty partners.⁸²

Sauvignon writes in the same sense:

... even if we suppose that the establishment of a multilateral preferential system constitutes a fundamental change in the circumstances and that this change had not been envisaged by the parties to the treaty providing for the most-favoured-nation treatment, the *clausula* would still not come into play: it cannot be invoked by a State when the State itself brought about the changed circumstances. (V.J. Leca, *Les techniques de révision des conventions multilatérales*, especially p. 312.)

It rests entirely with the granting State to refuse to accede to the multilateral agreement establishing the preferential system.⁸³

51. (F) The rather isolated arguments of Pescatore have been dealt with already in these reports. One is based upon an unjustified extension of the *ejusdem generis* rule:

There is no common measure between a treaty designed simply to facilitate international trade and the much more ambitious and fundamental objective of a treaty designed to bring about economic integration in the form of a free-trade area, a customs union or an economic union. It has thus been concluded that the "commercial" most-favoured-nation clause has no effect with regard to advantages granted within the framework of an integration system ... etc.⁸⁴

The other is based on a somewhat arbitrary and only partially relevant argument that national treatment can generally not be attracted by most-favoured-nation clause and even less so, if national treatment is accorded within an economic union.⁸⁶

As to the view of the Special Rapporteur on these ideas, the reader is referred to the fourth and fifth reports.⁸⁶

Even Sauvignon⁸⁷ and Vignes⁸⁸ seem to be rather sceptical concerning these views.

52. (G) The crux of the matter is, of course, whether the existence of a customary rule of an implied customs union exception can be established. This is after all the thesis often put forward in literature and supported mostly by the frequency of the exception-stipulations. What is necessary for the establishment of the existence of a customary rule of international law has been again examined quite recently by the International Court of Justice. In its judgment in the North Sea Continental Shelf case the Court affirmed that rules while only conventional or contractual in their origin, might pass into the general *corpus* of international law and might be accepted as such by the *opinio juris*, so as to become binding even for countries which had never, and did not

⁷⁸ Treaty instituting the European Coal and Steel Community, section 17 of the Convention on Transitional Provisions (United Nations, Treaty Series, vol. 261, pp. 297 and 299; and Treaty establishing the European Atomic Energy Community, articles 105–106 (*ibid.*, vol. 298, p. 205).

⁷⁹ Treaty concerning the accession of the Kingdom of Denmark, Ireland, the Kingdom of Norway and the United Kingdom of Great Britain and Northern Ireland to the European Economic Community and to the European Atomic Energy Community: Act concerning the conditions of accession and the adjustments to the treaties, article 4 (*Official Journal of the European Communities—Legislation*, Special Edition, Luxembourg, 27 March 1972, No. L. 73, pp. 14–15).

⁸⁰ *Yearbook... 1974*, vol. II (Part One), pp. 253–254, document A/9610/Rev. 1, chap. II, sect. D, paras. 4 and 5 of the commentary to articles 30, 31 and 32.

⁸¹ Hay, *loc. cit.*, p. 681.

⁸² *Ibid.*, pp. 681–682.

⁸³ Sauvignon, *op. cit.*, p. 254, note 2.

⁸⁴ *Annuaire de l'Institut de droit international*, 1969 (Basle), vol. 53, t. Ier, (1969), p. 209.

⁸⁵ *Ibid.*, p. 208.

⁸⁶ See *Yearbook... 1973*, vol. II, pp. 107–108, document A/CN.4/266, paras. 13–16 of the commentary to article 7; and *Yearbook... 1974*, vol. II, (Part One), pp. 127–128, document A/CN.4/280, para. 8 of the commentary to article 13.

⁸⁷ Sauvignon, *op. cit.*, p. 53, foot-note 2, pp. 73–74 and pp. 234–235.

⁸⁸ Vignes, *op. cit.*, pp. 282–283 and foot-note 65.

become parties to the convention in question. According to the Court this process is perfectly possible and does from time to time occur. This result, however, is not lightly to be regarded as having been attained.⁸⁹ According to the Court, for the formation of a new rule of customary international law on the basis of what was originally a purely conventional rule, "an indispensable requirement would be that . . . State practice, including that of States whose interests are specially affected, should have been both extensive and virtually uniform in the sense of the provision invoked—and should moreover have occurred in such a way as to show a general recognition that a rule of law or legal obligation is involved".⁹⁰ As to the nature of the required State practice the Court holds that it must be "settled" and moreover carried out in such a way, "as to be evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it. The need for such a belief, i.e. the existence of a subjective element, is implicit in the very notion of the *opinio juris sive necessitatis*. The States concerned must therefore feel that they are conforming to what amounts to a legal obligation. The frequency even or habitual character of the acts is not in itself enough".⁹¹

53. (H) That the alleged customary rule of an implied customs union exception (and the more so of an exception of other kinds of groupings) falls far short of the requirements set out above, needs hardly any proof. To remain in the orbit of the problems connected with EEC, which is based upon a customs union (article 9 of the Treaty of Rome) it seems to be clear that not only did the founders of the Community not rely upon a rule of exception in the case of customs unions, but, on the contrary, they "unmistakably" approached "the question of pre-Community treaties from the angle of the rules governing the application of successive treaties relating to the same subject matter (article 30 of the Vienna Convention)".⁹² The stand taken in 1957 was reaffirmed in 1972 on the occasion of the conclusion of the Treaty of Accession of 22 January 1972 which again deals with the pre-accession treaties of the candidate States on the basis of compatibility of treaty obligations—in requiring them to bring their existing treaty obligations into line with the obligations arising from their accession to the Communities.

54. In these circumstances it is difficult to attribute sufficient weight to the official paper of the then Government of the Federal Republic of Germany which in 1957, relying on the customs union exception, interpreted article 234 of the Rome Treaty in its explanations submitted to the Parliament, to mean that the six member States have agreed that EEC benefits are excepted from the application of the most-favoured-nation clause.⁹³ Nor can the

fact that controversies, protests and diplomatic steps have led in several cases to more or less satisfactory compromises mostly to the detriment but sometimes to the benefit of outsiders be considered as sufficient to establish a general practice and *communis opinio* of States.⁹⁴

55. (I) No adherent of the implied customs union exception has ever offered a satisfactory solution to the formidable problem presented by those treaties which contain explicit provisions as to one or more exceptions to the clause without reference to customs unions or the like. How could the implied customs union exception surmount the formidable difficulty of the *inclusio unius, exclusio alterius* principle?

56. (J) Mention should be made finally of the views of modern authors, who in recent times have adopted a negative position in regard to the implied customs union exception rule. In addition to those already mentioned reference can be made to Usenko, who in the standard Soviet textbook writes as follows:

It is impossible to agree with the view that there exists a rule of international law which excepts from the scope of the principle of most-favoured-nation treatment advantages granted under a customs union. If such an exception existed in international law, it would not be necessary for States, whenever they wish to make this exception, to enter scrupulous reservations in trade agreements to the effect that the scope of the principle of most-favoured-nation treatment does not extend to any advantages resulting from the customs union...

Since there are no rules of a non-treaty nature in international law which might establish exceptions to the most-favoured-nation clause (see below for exceptions in the case of the developing countries), it follows that the only lawful exceptions are those which are made with the agreement of the country to which they are applied.⁹⁵

The same view is held by a Polish scholar, T. Szurski.⁹⁶

57. M. Giuliano, in his Hague lectures, after a thorough analysis of the relevant practice of States comes to the following conclusion:

In the light of the facts of international practice which we have just considered, it seems clear that the doctrine in question [i.e. the implied customs union exception] is not established in international law. If a treaty does not contain an explicit provision to the contrary, the most-favoured-nation treatment must also be extended to the advantages resulting from a customs union between one or other of the contracting parties and a third State.

Giuliano adds however:

Nevertheless, an entirely different problem is that of the timeliness or, if you wish, the reasonableness of the limitations imposed on the operation of the clause which were discussed earlier. From this standpoint, there cannot be any room for doubt, since—as we have already had an opportunity to note—the problem of the equal treatment of nations in trade matters never arises in the abstract and as a principle having absolute validity. And it is precisely for that reason that Governments have always taken great care to insert these exceptions in trade treaties.⁹⁷

⁸⁹ *I.C.J. Reports 1969*, p. 42.

⁹⁰ *Ibid.*, p. 44.

⁹¹ *Ibid.*, p. 45.

⁹² See above, para. 48.

⁹³ See *Verhandlung des Deutschen Bundestags, 2. Wahlperiode 1953: Anlagen zu den stenographischen Berichten*, vol. 57 (Bonn, 1957), Drucksache [fascicle] 3440, p. 157. See also the remarks of E.T. Usenko in State Institute of Law of the Soviet Academy of Sciences, [F.I. Kozhevnikov et al eds.], *Kurs mezhdunarodnogo prava*, vol. IV (Moscow, Nauka, 1968), p. 268.

⁹⁴ Sauvignon, *op. cit.*, p. 246.

⁹⁵ State Institute of Law of the Soviet Academy of Sciences, *Kurs...* (*op. cit.*), p. 268.

⁹⁶ *Zasada największego uprzywilejowania w Uchadzie Ogólnym w Sprawie Taryf Celnych i Handly (GATT)* (Warsaw, 1970), chap. IV.

⁹⁷ M. Giuliano, "Quelques aspects juridiques de la co-opération intergouvernementale en matière d'échanges et de paiements internationaux", *Recueil des Cours ... 1968*, — II vol. 124 (Leiden, Sijthoff, 1969), pp. 601–602.

B. De lege ferenda

58. Should the Commission evaluate the situation as one where progressive development of international law is needed in the sense that the benefits of customs unions, etc. become a full-fledged exception to the operation of the most-favoured-nation clause? The Special Rapporteur's answer to this question would be in the negative. His reasons are as follows.

59. (A) The expression of such need would involve a value judgement as to the desirability of establishing customs unions, etc. Whether the formation of such groupings is desirable or not leads us from the field of law to that of economics, which the Commission may not wish to enter. However, even economists are not entirely certain whether regional arrangements are beneficial and, if so, what characteristics differentiate the beneficial ones from the detrimental ones.⁹⁸

60. How formidable are the economic questions involved is well summarized by a great expert on the matter, Professor Gardner Patterson, as follows:

There was a great flowering of theoretical work on the whole question of the economic aspect of regional economic groupings.¹ There is space here only to point out that this theoretical work demonstrated that the problem was a very complex one and that any such regional integration would have several economic effects. It would create some trade among the members; that is, some members would now buy goods from another member rather than produce them themselves because the goods in question were no longer subject to tariffs, etc. It would divert some trade away from non members to members; that is, some members would now buy from another member goods which had previously been bought from a non member because those from the latter now had to bear higher duties than those from the former. It would shift consumption from some goods produced by non members to different goods produced by members because the latter goods were now less expensive to consumers as a result of the change in tariff structures. It would probably improve the members' terms of trade vis-à-vis non members. All of these except the first would tend to be harmful to non members. But, the theoretical analysis showed, there were also "dynamic" effects. Regionalism would probably also have a favorable effect on the rate of growth of the members, as compared with the previous situation. This is because it would permit fuller exploitation of economies of scale, especially in those firms or industries benefitting from any trade creation; because of the buoyant effects of larger duty-free markets on entrepreneurial expectations and so investment; because of the restraining effects of larger markets upon monopolistic practices; because of external economies, including better use of the areas' technological and organizational skills, etc. This faster rate of growth, in turn, would tend to increase members' imports from non members. This theoretical analysis showed that the net effect of all this on non members and on the world as a whole, could be either beneficial or detrimental, depending on the particular facts of the case. Very little could, in fact, be said in the absence of the facts on cost conditions, mobility of resources, elasticities of demand, etc., etc. And few of these facts were in any instance available.

Perhaps most important of all, the most recent theoretical analysis has shown that if members of a regional bloc place a collective community value not only on the flow of goods and services to the market-places but also on the fact of industrialization or diversification *per se*, then the participants may come to value trade diversion for its own sake for this is the way in which each member can increase its own level of industrialization or degree of diversification, be it

admittedly at the cost of economic efficiency and of lost markets by non members. Indeed, as the theoretical literature cited above has noted, from the point of view of the members, except for the probably not very important terms of trade effects, there are few if any strictly economic efficiency aspects, or economic welfare grounds as usually defined, on which a discriminatory regional bloc is superior to unconditional most-favored-nation free trade arrangements. There are, of course, non-economic arguments for regional economic integration, and given the practice of demanding reciprocity as a condition for tariff cuts MFN free trade arrangements may often not be a genuine alternative, but this last point does lend support to the view that, on purely economic grounds at least, one of the great attractions of regional economic groupings to their members is precisely that they do divert trade away from non members.

¹ The literature is now extensive, but the classics are: Jacob Viner, *The Customs Union Issue*, 1950; James Meade, *The Theory of International Economic Policy*, Vol. I, *The Balance of Payments*, 1951 and Vol. II, *Trade and Welfare*, 1955, and *The Theory of Customs Unions*, 1956; R.G. Lipsey and Kelvin Lancaster, "The General Theory of Second Best", *Review of Economic Studies*, 1956-1957, No. 63, pp. 11-32; R.G. Lipsey, "The Theory of Customs Unions: A General Survey", *Economic Journal*, September 1960; J.M. Fleming "On Making the Best of Balance of Payments Restrictions on Imports", *Economic Journal*, March 1951, pp. 48-71; Tibor Scitovsky, *Economic Theory and Western European Integration*, 1958, and Bela Balassa, *The Theory of Economic Integration*, 1961. Harry G. Johnson, in his *Money, Trade, and Economic Growth*, 1962, pp. 46-74, gives an excellent short synthesis and extension of this literature. See also C.A. Cooper and B.F. Massell, "Toward a General Theory of Customs Unions for Developing Countries", *The Journal of Political Economy*, October 1965, pp. 461-476.⁹⁹

61. (B) If for one reason or another one should still wish to draft a rule establishing a general exception of customs unions and other like associations one would encounter tremendous difficulties. How should such a rule define a customs union, a free-trade area and other relevant groupings? Should it take over the terms of GATT which, as we have seen above, were not conducive to the legal solution of the difficulties which have arisen in regard to such unions? How would non-GATT members react to such proposal? There are still some 60 such States in the world, representing a considerable part of its population. Or should we simply refer in such a rule to customs unions, free-trade areas, etc. without elaborating further on the meaning of these notions as is frequently done in bilateral treaties? We would then arrive to a result which—in the words of the Court—owing to "the very considerable, still unresolved controversies as to the exact meaning and scope of this notion, must raise further doubts as to the potential norm-creating character of the rule".¹⁰⁰

62. (C) Under these circumstances, the Special Rapporteur's conclusion is, that:

Because no customary rule of international law exists establishing an implied customs union exception, etc.; because, further, it is a general practice of States to insert in their treaties any exception they may wish to make in regard to their most-favoured-nation pledge; and because there is no compelling evidence as to the desirability of substituting a general rule for the particular arrangements of the parties the best course of action is to leave matters where they are.

63. While the Special Rapporteur has given much thought to this question and has devoted a considerable part of his present report to it, he would not wish to exaggerate its importance. In the relation between States

⁹⁹ G. Patterson, "The most-Favored-Nation Clause and Economic Integration", *Annuaire européen*, 1965 (The Hague), vol. XIII (1967), pp. 148-149.

¹⁰⁰ North Sea Continental Shelf Cases, *ICJ Reports 1969*, p. 43.

⁹⁸ Jackson, *op. cit.*, p. 621.

parties to GATT, article XXIV more or less settles the matter. In relations between them and outsiders and between outsiders *inter se* stipulations making exceptions to a most-favoured-nation clause are very frequent. Where such exceptions include a reference to a customs union or a free-trade area etc., the problem is settled more or less according to the precision of the stipulation. Where exceptions are stipulated in other matters but not in regard to customs unions, as e.g. in the USSR-Australia treaty of 1965, quoted above,¹⁰¹ it is the feeling of the Special Rapporteur, that the *inclusio unius, exclusio alterius* principle cannot be overruled. There remain the presumably not too numerous cases where the clause stands without any stipulated exception whatsoever. Hence it could be said that the problem—if one exists—is marginal even if in individual cases it is aggravated by the bitterness of the dispute between the party which was not circum-spect enough when drafting the treaty and the one which feels that its rights and interests based on the clause are violated.

Thus the Special Rapporteur's choice is not to propose to create customs and other unions exceptions to the general rule. This he submits with one reservation: the matter will be reviewed in the course of the further study on the functioning of the clause in relation to the developing countries. In the course of this review account will be taken of the situation as described in annex I to the second report under the heading "Trade among developing countries"¹⁰² as well as of more recent developments.

IV. The most-favoured-nation clause and the different levels in the economic development of States

64. This is a field where in recent years dramatic developments have taken place. On this the Special Rapporteur wrote a few years ago as follows:

I think that we cannot fail to recognize that international law does have new rules in this field, or, at least, that such rules are being evolved. According to the emerging *communis opinio*, it has become the duty of the developed industrialized countries to grant preferences to the developing countries. In his book on GATT, Flory—invoking Lacharrière and Virally— writes as follows: "The principle of the duality of the rules applicable to the industrialized countries and to the developing countries is tending to become one of the new principles of international economic and trade law. In short, the new principle of the duality of regulations corresponds to the idea of a law suited to the economic problems of underdevelopment and differs from the principle governing relations among the developed countries. It is based on the new international law of development" (p. 189). This statement is in keeping with the urgent claims which have been pressed at the sessions of UNCTAD.

...
We must see clearly that the most urgent task and the common responsibility of today's generation—and indeed of the generations of the future—is to come to the aid of the developing countries. In the final analysis, this is a question of human rights, of the right to

life, and often of the right to life alone, of several hundreds of millions of people.¹⁰³

In the present context we shall have to follow these developments only in so far as they have a bearing on the operation of most-favoured-nation clauses.

Developments in UNCTAD

65. On the general problems created by the different levels of economic development for the operation of the most-favoured-nation clause in the field of international commerce, the Special Rapporteur—for lack of space— simply and respectfully refers to the passage in his second report entitled: "Developing countries and the most-favoured-nation clause in general".¹⁰⁴ Furthermore, the same report, under the heading "The case for preferences in favour of developing countries in their trade with developed countries", sets out, on the basis of a memorandum received from UNCTAD, the fundamental difference between the so-called special or vertical or preferential arrangements between *some* developing countries and *some* developed countries and a generalized, non-reciprocal, non-discriminatory system of preferences. It outlines the *unanimous* agreement, reached at the Second UNCTAD Conference in 1968 and embodied in resolution 21 (II), favouring the introduction of this latter type of preference system. The necessity of gradually phasing out the special preferences is also explained.¹⁰⁵

66. Later in 1970, in a period not covered by the Special Rapporteur's second report, the Special Committee on Preferences, established by resolution 21 (II) of UNCTAD as a subsidiary organ of the Trade and Development Board, succeeded in reaching "Agreed conclusions" on a generalized system of preferences and these conclusions were annexed to decision 75(S-IV) of the Trade and Development Board.¹⁰⁶

The following are excerpts from that very important document:

I

The Special Committee on Preferences:

1. Recalls that in its resolution 21 (II) of 26 March 1968 the United Nations Conference on Trade and Development recognized the unanimous agreement in favour of the early establishment of a mutually acceptable system of generalized, non-reciprocal, non-discriminatory preferences which would be beneficial to the developing countries;

2. Further recalls the agreement that the objectives of the generalized, non-reciprocal, non-discriminatory system of preferences in favour of the developing countries, including special measures in favour of the least developed among the developing countries, should be: (a) to increase their export earnings; (b) to promote

¹⁰¹ See para. 11 above.

¹⁰² *Yearbook...* 1970, vol. II, p. 238, document A/CN.4/228 and Add.1.

¹⁰³ *Annuaire de l'Institut de Droit International*, 1969 (Basle), vol. 53, tome I (1969), pp. 276-278.

¹⁰⁴ *Yearbook...* 1970, vol. II, p. 231, document A/CN.4/228 and Add.1, para. 188.

¹⁰⁵ *Ibid.*, pp. 234-235, para. 200.

¹⁰⁶ *Official Records of the General Assembly, Twenty-fifth Session, Supplement No. 15 (A/8015/Rev.1)*, pp. 265 *et seq.*

their industrialization; and (c) to accelerate their rates of economic growth;

...

9. Recognizes that these preferential arrangements are mutually acceptable and represent a co-operative effort which has resulted from the detailed and intensive consultations between the developed and developing countries which have taken place in UNCTAD. This co-operation will continue to be reflected in the consultations which will take place in the future in connexion with the periodic reviews of the system and its operation.

10. Notes the determination of the prospective preference-giving countries to seek as rapidly as possible the necessary legislative or other sanction with the aim of implementing the preferential arrangements as early as possible in 1971;

...

II

REVERSE PREFERENCES AND SPECIAL PREFERENCES

1. The Special Committee notes that, consistent with Conference resolution 21 (II), there is agreement with the objective that in principle all developing countries should participate as beneficiaries from the outset and that the attainment of this objective, in relation to the question of reverse preferences, which remains to be resolved, will require further consultations between the parties directly concerned. These consultations should be pursued as a matter of urgency with a view to finding solutions before the implementation of the schemes. The Secretary-General of UNCTAD will assist in these consultations with the agreement of the Governments concerned.

...

III

SAFEGUARD MECHANISMS

1. All proposed individual schemes of preferences provide for certain safeguard mechanisms (for example, *a priori* limitation or escape-clause type measures) so as to retain some degree of control by preference-giving countries over the trade which might be generated by the new tariff advantages. The preference-giving countries reserve the right to make changes in the detailed application as in the scope of their measures, and in particular, if deemed necessary, to limit or withdraw entirely or partly some of the tariff advantages granted. The preference-giving countries, however, declare that such measures would remain exceptional and would be decided on only after taking due account, in so far as their legal provisions permit, of the aims of the generalized system of preferences and the general interests of the developing countries, and in particular the interests of the least developed among the developing countries.

...

IV

BENEFICIARIES

1. The Special Committee noted the individual submissions of the preference-giving countries on this subject and the joint position of the countries members of the Organisation for Economic Co-operation and Development as contained in paragraph 13 of the introduction to the substantive documentation containing the preliminary submissions of the developed countries; ⁹ namely:

"As for beneficiaries, donor countries would in general base themselves on the principle of self-election. With regard to this principle, reference should be made to the relevant paragraphs in document TD/56^a, i.e., Section A in Part I".

...

V

SPECIAL MEASURES IN FAVOUR OF THE LEAST DEVELOPED AMONG THE DEVELOPING COUNTRIES

1. In implementing Conference resolution 21 (II), and as provided therein, the special need for improving the economic situation of the least developed among the developing countries is recognized. It is important that these countries should benefit to the fullest extent possible from the generalized system of preferences. In this context, the provisions of Conference resolution 24 (III) of 26 March 1968 should be borne in mind.

2. The preference-giving countries will consider, as far as possible, on a case-by-case basis, the inclusion in the generalized system of preferences of products of export interest mainly to the least developed among the developing countries, and as appropriate, greater tariff reductions on such products.

...

VI

DURATION

The initial duration of the generalized system of preferences will be ten years. A comprehensive review will be held some time before the end of the ten-year period to determine, in the light of the objectives of Conference resolution 21 (II), whether the preferential system should be continued beyond that period.

VII

RULES OF ORIGIN

1. It is agreed that the rules of origin should facilitate the achievement of the objectives of Conference resolution 21 (II) on the generalized system of preferences, in this connexion, to ensure effectively for the beneficiary countries the advantages of preferential treatment for those exports which will qualify therefor; to help to ensure equivalence in conditions of access to the markets of the preference-giving countries, and to avoid distortion of trade.

2. Satisfactory functioning of the rules of origin will be greatly helped if it is possible to establish close and confident collaboration between the competent authorities of the donor and beneficiary countries, particularly concerning documentation and control. It is agreed that such co-operation should be assured bilaterally and as appropriate through the institutional arrangements as provided for in the relevant part of these conclusions.

3. It is recognized that it is desirable to have rules of origin as uniform as possible and as simple to administer as practicable. The Working Group on Rules of Origin had, at a technical level, formulated preliminary texts on a number of important aspects of the rules of origin. However, in regard to the basic element, for any rules of origin, namely, the criterion for substantial transformation, the Group did not at this stage arrive at common views.

...

VIII

INSTITUTIONAL ARRANGEMENTS

1. The Special Committee on Preferences agrees that there should be appropriate machinery within UNCTAD to deal with the questions relating to the implementation of Conference resolution 21 (II) bearing in mind Conference resolution 24 (II). The [appropriate UNCTAD body] should have the following terms of reference:

(a) It will review:

- (i) The effects of the generalized system of preferences on exports and export earnings, industrialization and the rates of economic growth of the beneficiary countries, including the least developed among the developing countries, and in so doing will consider, *inter alia*, questions related to product coverage, exception lists, depths of cut, working of safeguard mechanisms (including ceilings and escape clauses) and rules of origin;

...

IX

LEGAL STATUS

1. The Special Committee recognizes that no country intends to invoke its rights to most-favoured-nation treatment with a view to obtaining, in whole or in part, the preferential treatment granted to developing countries in accordance with Conference resolution 21 (II), and that the Contracting Parties to the General Agreement on Tariffs and Trade intend to seek the required waiver or waivers as soon as possible.

2. The Special Committee takes note of the statement made by the preference-giving countries that the legal status of the tariff preferences to be accorded to the beneficiary countries by each preference-giving country individually will be governed by the following considerations:

- (a) The tariff preferences are temporary in nature;
- (b) Their grant does not constitute a binding commitment and, in particular, it does not in any way prevent:
 - (i) Their subsequent withdrawal in whole or in part; or
 - (ii) The subsequent reduction of tariffs on a most-favoured-nation basis, whether unilaterally or following international tariff accommodations;
- (c) Their grant is conditional upon the necessary waiver or waivers in respect of existing international obligations, in particular in the General Agreement on Tariffs and Trade.

[#] TD/B/AC.5/24.

^{*} See *Proceedings of the United Nations Conference on Trade and Development, Second Session*, vol. III and Corr. 2, *Problems and policies of trade in manufactures and semi-manufactures* (United Nations publication, Sales No. E.68.11.D.16), document TD/56, annex, part one, section A.

67. The General Assembly took note of the unanimous agreement reached in the Special Committee on preferences by including the following passage in the International Development Strategy for the Second United Nations Development Decade, adopted by resolution 2626 (XXV):

(32) Arrangements concerning the establishment of generalized, non-discriminatory, non-reciprocal preferential treatment to exports of developing countries in the markets of developed countries have been drawn up in the United Nations Conference on Trade and Development and considered mutually acceptable to developed and developing countries. Preference-giving countries are determined to seek as rapidly as possible the necessary legislative or other sanction with the aim of implementing the preferential arrangements as early as possible in 1971. Efforts for further improvements of these preferential arrangements will be pursued in a dynamic context in the light of the objectives of resolution 21 (II) of 26 March 1968, adopted by the Conference at its second session.

Development in GATT

68. In the second report on the most-favoured-nation clause a brief description was given of part IV of the General Agreement which was added to the original text

in 1966 with the intention of satisfying the trade needs of developing countries.¹⁰⁷ It did not take too long to detect that the provisions of part IV were insufficient. On the basis of the agreement reached at the second session of UNCTAD and in the Special Committee on Preferences, the Governments members of GATT have voted to authorize the introduction by developed member countries of generalized, non-discriminatory preferential tariff treatment for products originating in developing countries.

The authorization takes the form of a waiver under the terms of article XXV of the General Agreement. The full text of the waiver is as follows:

The CONTRACTING PARTIES to the General Agreement on Tariffs and Trade,

Recognizing that a principal aim of the CONTRACTING PARTIES is promotion of the trade and export earnings of developing countries for the furtherance of their economic development,

Recognizing further that individual and joint action is essential to further the development of the economies of developing countries,

Recalling that at the Second UNCTAD, unanimous agreement was reached in favour of the early establishment of a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries in order to increase the export earnings, to promote the industrialization, and to accelerate the rates of economic growth of these countries,

Considering that mutually acceptable arrangements have been drawn up in the UNCTAD concerning the establishment of generalized, non-discriminatory, non-reciprocal preferential tariff treatment in the markets of developed countries for products originating in developing countries,

Noting the statement of developed contracting parties that the grant of tariff preferences does not constitute a binding commitment and that they are temporary in nature,

Recognizing fully that the proposed preferential arrangements do not constitute an impediment to the reduction of tariffs on a most-favoured-nation basis,

Decide:

(a) That without prejudice to any other Article of the General Agreement, the provisions of Article I shall be waived for a period of ten years to the extent necessary to permit developed contracting parties, subject to the procedures set out hereunder, to accord preferential tariff treatment to products originating in developing countries and territories with a view to extending to such countries and territories generally the preferential tariff treatment referred to in the Preamble to this Decision, without according such treatment to like products of other contracting parties

Provided that any such preferential tariff arrangements shall be designed to facilitate trade from developing countries and territories and not to raise barriers to the trade of other contracting parties;

(b) That they will, without duplicating the work of other international organizations, keep under review the operation of this Decision and decide, before its expiry and in the light of the considerations outlined in the Preamble, whether the Decision should be renewed and if so, what its terms should be;

(c) That any contracting party which introduces a preferential tariff arrangement under the terms of the present Decision or later modifies such arrangement, shall notify the CONTRACTING PARTIES and furnish them with all useful information relating to the actions taken pursuant to the present Decision;

(d) That such contracting party shall afford adequate opportunity for consultations at the request of any other contracting party which

¹⁰⁷ *Yearbook... 1970*, vol. II, p. 232, document A/CN.4/228 and Add.1, para. 192.

considers that any benefit accruing to it under the General Agreement may be or is being impaired unduly as a result of the preferential arrangement;

(e) That any contracting party which considers that the arrangement or its later extension is not consistent with the present Decision or that any benefit accruing to it under the General Agreement may be or is being impaired unduly as a result of the arrangement or its subsequent extension and that consultations have proved unsatisfactory, may bring the matter before the CONTRACTING PARTIES which will examine it promptly and will formulate any recommendations that they judge appropriate.¹⁰⁸

The functioning of the generalized system of preferences

69. The Soviet Union was the first country which introduced as early as 1965 a unilateral system of duty-free imports from developing countries. Such duty-free treatment applies to all products. No conditions in respect of duration or the reimposition of duties are attached. As the Soviet representative in the Special Committee on Preferences explained, the USSR would, in addition to according tariff preferences, continue with a number of other measures designed to increase its imports from developing countries on the lines outlined in the Joint Declaration of the Socialist Countries of Eastern Europe.¹⁰⁹

70. Australia followed suit in 1966 with a more restricted unilateral system, and Hungary announced its own in 1968. According to the latter—as it has been amplified and improved in 1971 and 1974—the Hungarian preferential list of products covers a wide range of products, both agricultural and industrial; it is based on requests of developing countries and includes items of special export interest for the least developed among the developing countries; the extent of tariff reductions is set forth by Government Decree; the preferential tariff rates are 50 to 90 per cent below the most-favoured-nation tariff rates and more than 100 products are accorded full duty exemption; beneficiary countries are those developing countries in Asia, Africa and Latin America whose *per capita* national income is less than Hungary's; which do not apply discrimination against Hungary; which maintain normal trade relations with Hungary and can give reliable evidence of the origin of products eligible for preferential tariff treatment; a product shall be deemed to originate in a beneficiary country if it has been produced in that country or 50 per cent of its value has been added to it in that country; a safeguard mechanism consists in the possibility that the Ministers of Foreign Trade and of Finance can, in collaboration with the President of the National Board for Materials and Prices increase, reduce or suspend the application of the tariff rates established in columns I, II and III (columns I and II of the customs tariff indicate “preferential” and “most-favoured-nation” tariff rates, respectively. The tariff rates

in column III are applied to goods originating from those countries to which neither preferential, nor most-favoured-nation treatment is applied).

This detailed regulation entered into force on 1 January 1971. In 1974, the number of beneficiary countries has been enlarged, the product coverage of the system has also been broadened and some tariff rates have been reduced.¹¹⁰

The Hungarian system allows preferences only provisionally for those countries which on 1 January 1972 extend special (reverse) preferences to certain developed countries. It is assumed that these reverse preferences will be eliminated by 31 December 1975.¹¹¹

71. The EEC has also announced a scheme of generalized preferences in 1971 allowing the duty-free entry of manufactured and semi-manufactured products from a number of developing States. Firm limits are set for the quantities which may be imported in this way and certain sensitive items such as textiles and shoes given less generous treatment.

72. The generalized system of preferences of the United States of America is contained in title V of its Trade Act.¹¹² Its section 501 authorizes the President to extend preferences. Section 502 defines the notion of a “beneficiary developing country” excluding from that notion—with certain exceptions—“communist countries” and others. Section 503 determines the articles eligible for preferential treatment, excluding some import sensitive articles. Section 504 contains limitation on preferential treatment. Section 505 sets a 10-year time-limit for duty-free treatment under the title and provides for a comprehensive review of the operation of the whole preferential system after five years.

73. It is perhaps too early to assess the results, success or failure, of the generalized system of preferences. Some voices of complaint have already been heard. According to the report of the Trade and Development Board on its fifth special session (1973) :

The representatives of developing countries stated that, while some progress might have been achieved in the implementation of the generalized system of preferences, the system itself was far from adequate in terms of its objectives and its performance thus far was disappointing ... They observed that the actual benefits of the scheme were still meagre because of the limited product coverage of the schemes in operation, ... the limitations imposed on preferential imports by ceilings and the application of non-tariff barriers on products covered by the system.

The representatives of several developing countries, including the least developed among them, felt that the generalized system of preferences was of little or no benefit, since their countries did not produce manufactures or semi-manufactures, but only supplied primary materials and semi-processed agricultural commodities which were not covered by the generalized system of preferences. In addition, they pointed out that the safeguard clauses presently embodied in the schemes allowed much leeway for limiting the scope

¹⁰⁸ GATT, *Basic Instruments and Selected Documents, Supplement No. 18* (Sales No: GATT/1972-1), pp. 24-26.

¹⁰⁹ See *Official Records of the Trade and Development Board, Tenth Session, Supplement No. 6A* (TD/B/329/Rev.1), part two, para. 192. See R. Krishnamurti, “The Agreement on preferences—a generalized system in favour of developing countries”, *Journal of World Trade Law* (Twickenham), vol. 5, No. 1 (Jan.-Feb. 1971), pp. 56-57.

¹¹⁰ GATT documents L/3301 and L/4106.

¹¹¹ *Ibid.*

¹¹² United States of America, *U.S. Code: Congressional and Administrative News* (Washington, D.C., 1975), No. 13 (30 January 1975), p. 6956 (93rd Congress, 2nd session, Public Law 93-618).

of preferences and made such preferences disparate, while creating considerable uncertainty.¹¹³

74. The Charter of Economic Rights and Duties of States proclaimed in General Assembly resolution 3281 (XXIX) also contains provisions pertinent to the problems under consideration. Thus, article 18, on the generalized system of preferences:

Developed countries should extend, improve and enlarge the system of generalized non-reciprocal and non-discriminatory tariff preferences to the developing countries consistent with the relevant agreed conclusions and relevant decisions as adopted on this subject, in the framework of the competent international organizations. Developed countries should also give serious consideration to the adoption of other differential measures, in areas where this is feasible and appropriate and in ways which will provide special and more favourable treatment, in order to meet the trade and development needs of the developing countries. In the conduct of international economic relations the developed countries should endeavour to avoid measures having a negative effect on the development of the national economies of the developing countries, as promoted by generalized tariff preferences and other generally agreed differential measures in their favour.

Again, article 26:

All States have the duty to coexist in tolerance and live together in peace, irrespective of differences in political, economic, social and cultural systems, and to facilitate trade between States having different economic and social systems. International trade should be conducted without prejudice to generalized non-discriminatory and non-reciprocal preferences in favour of developing countries, on the basis of mutual advantage, equitable benefits and the exchange of most-favoured-nation treatment.

Articles 12, para. 1, and 21 on regional groupings:

Article 12

1. States have the right, in agreement with the parties concerned, to participate in subregional, regional and interregional co-operation

¹¹³ *Official Records of the General Assembly, Twenty-eighth Session, Supplement No. 15 (A/9015/Rev.1)*, pp. 21-22, part one, chap. I, paras. 89-90.

in the pursuit of their economic and social development. All States engaged in such co-operation have the duty to ensure that the policies of those groupings to which they belong correspond to the provisions of the Charter and are outward-looking, consistent with their international obligations and with the needs of international economic co-operation, and have full regard for the legitimate interests of third countries, especially developing countries.

Article 21

Developing countries should endeavour to promote the expansion of their mutual trade and to this end, may, in accordance with the existing and evolving provisions and procedures of international agreements where applicable, grant trade preferences to other developing countries without being obliged to extend such preferences to developed countries, provided these arrangements do not constitute an impediment to general trade liberalization and expansion.

Preliminary conclusions

75. What remains to be done after this sketchy presentation of the situation regarding trade (movement of goods) between developed and developing countries, is the formulation of legal rules which adequately reflect the *communis opinio* discernible from the diverse manifestations of States. The main line of at least one of such rules has been given by the agreed conclusions reached by the Special Committee on Preferences.¹¹⁴ Thus an exception seems to be recognized to the operation of most-favoured-nation clauses relating to customs tariffs and similar matters in the following sense: if the beneficiary State of such a clause is a developed State, it is not entitled under the clause to claim the benefits accorded in the framework of a developed granting State's scheme of generalized preferences to a developing State.

Before presenting, however, a more precise formulation of this rule—and presumably of others—the Special Rapporteur wishes to study the matter further and possibly consult with the Commission.

¹¹⁴ See Section IX (Legal status) of the Special Committee's agreed conclusions reproduced in para. 66 above.