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

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# MOST-FAVoured-NATION CLAUSE

[Agenda item 4]

## DOCUMENT A/CN.4/213

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#### Introduction

1. In the introduction to the working paper submitted at the twentieth session of the International Law Commission,<sup>1</sup> the present Special Rapporteur gave an account of the circumstances under which the Commission had decided to begin the study of the topic of most-favoured-nation clauses in the law of treaties. The subsequent events are as follows:

2. As reflected in chapter IV of the report on the work of its twentieth session,<sup>2</sup> the Commission discussed the

matter briefly and gave instructions to the Special Rapporteur. According to the instructions, the studies to be undertaken should not be confined to the field of international trade. Although the fundamental importance of the role of the most-favoured-nation clause in this domain was expressly recognized, the Special Rapporteur was asked to explore all the major fields of application of the clause.

3. The Commission stated in its report that it wished to focus on the legal character of the clause and the legal conditions governing its application; and to clarify the scope and effect of the clause as a legal institution in the context of all aspects of its practical application.

4. Finally the Commission expressed its wish to base its studies on the broadest possible foundations without,

<sup>1</sup> *Yearbook of the International Law Commission, 1968*, vol. II, document A/CN.4/L.127, p. 165.

<sup>2</sup> *Ibid.*, document A/7209/Rev.1, p. 223.

however, entering into fields outside its responsibilities.

5. In the light of these considerations, the Commission instructed the Special Rapporteur to consult, through the Secretariat, all organizations and interested agencies which might have particular experience in the application of the most-favoured-nation clause.

6. Having acted according to these instructions and while awaiting the answers to all the letters sent by the Secretariat to thirty-three agencies, the Special Rapporteur began to work according to the plan outlined in his above-mentioned working paper and prepared the present report.

7. The report attempts to give an outline of the history of the clause mainly in the domain of international trade, its chief field of application. It does not go further in time than the end of the Second World War, it being the belief of the Special Rapporteur that the history of the last twenty-five years is too closely related to the activities of the agencies whose answers are awaited. A particular place is given in the report to the works on the clause which were undertaken in the League of Nations and under its aegis. Notwithstanding the great changes which have taken place since the times of the League, the research undertaken in its various bodies and for the conferences of the inter-war period contains a wealth of material and is still of a considerable doctrinal value.

8. While giving a picture—admittedly fragmentary—of the history of the clause, it is also the purpose of the report—which does not pretend to be based on original research<sup>3</sup>—to collect and present the available material both in respect of the legal problems as they emerged in the given period and, to a lesser extent, in respect of the economic and political context with which the clause is inextricably linked.

9. The Special Rapporteur hopes to be able to complete the present report by another one which will be based largely on the answers of the organizations and agencies consulted and will contain also an account of the three cases dealt with by the International Court of Justice pertaining to the clause: the *Anglo-Iranian Oil Company Case (jurisdiction)* [1952],<sup>4</sup> the *Case concerning rights of nationals of the United States of America in Morocco* [1952],<sup>5</sup> and the *Ambatielos Case (merits: obligation to arbitrate)* [1953].<sup>6</sup> Such preparatory work may then serve as a sufficient basis for the substantial work of codification: the drafting of the rules of modern international law on the most-favoured-nation clause.

<sup>3</sup> Sir Gerald Fitzmaurice entered a *caveat* on this point in his fifth report on the law of treaties, see *Yearbook of the International Law Commission, 1960*, vol. II, document A/CN.4/130, p. 74, para 8.

<sup>4</sup> *I.C.J. Reports 1952*, p. 93.

<sup>5</sup> *Ibid.*, p. 176.

<sup>6</sup> *I.C.J. Reports 1953*, p. 10.

## CHAPTER I

### A short history of the most-favoured-nation clause up to the Second World War

#### 1. *The beginnings: unilateral grants*

10. The most-favoured-nation clause can be traced back to the eleventh century. The merchants of the Middle Ages tried in the first place to secure a monopoly for themselves in the exploitation of a foreign—and therefore far and difficult—market. When, however, with the development of commerce, such efforts failed and, accordingly, they had not succeeded in excluding their competitors from a given market, they strove to gain opportunities at least equal to those of their rivals. Thus the jealousy and competition between the merchants of the Italian, French and Spanish trading cities compelled them to content themselves with equal opportunities in foreign lands. It was at the insistence of the Mediterranean French and Spanish cities that Arab princes of western Africa issued franchises in which the merchants of those cities were accorded the same treatment as granted to the citizens of Venice and later to those of Pisa, Genoa, Ancona and Amalfi.

11. Similar franchises and stipulations were solicited and received in the twelfth century from the Byzantine Emperors by Venice. This city secured for its merchants in this way the same rights and privileges as were granted to the Genoans and Pisans. Promises of the same kind were sought from and given by the French princes of the Kingdom of Jerusalem to several trading cities of the Mediterranean. These transactions related to the personal rights of and jurisdictional favours for the merchants rather than to concessions in respect of customs duties.

12. Within the Holy Roman Empire, Imperial grants of customs privileges were given to certain cities on the basis of favours obtained “by whatsoever other town”. Such privileges were accorded to Mantua by Emperor Henry III in 1055. Emperor Frederic II conceded to the City of Marseilles in 1226 the privileges previously granted to the citizens of Pisa and Genoa. From this early period, treaties between England and continental cities such as Cologne have also been mentioned.<sup>7</sup>

#### 2. *Bilateral treaty clauses appear*

13. It is not until the fifteenth century that more elaborate texts are quoted. Thus a treaty between Henry V of England and the Duke of Burgundy and Count of Flanders of 17 August 1417 contained the following clause:

*Les Maistres de Neifs et Maronniers de la Partie d'Engleterre, a leur venue es Ports et Havres de nôtre dit Pays de Flandres, porront*

<sup>7</sup> S. Basdevant, “Clause de la nation la plus favorisée”, in A. de Lapradelle et J.-P. Niboyet, *Répertoire de droit international* (Paris, Recueil Sirey, 1929), t. III, pp. 464 and 468; A. Nussbaum, *A Concise History of the Law of Nations* (New York, MacMillan, 1954) rev. ed., p. 33; B. Nolde, “Droit et technique des traités de commerce” and “La clause de la nation la plus favorisée et les tarifs préférentiels”, *Recueil des cours de l'Académie de droit international de La Haye, 1924* (II), t. 3, p. 295, and *ibid.*, 1932, t. 39, p. 5; G. Schwarzenberger, “The Most-Favoured-Nation Standard in British State Practice”, *The British Yearbook of International Law, 1945* (London, Oxford University Press), vol. XXII, p. 97.

*faire licitement lier leur Neifs es dis Ports et Havres, par la manière que feront François, Hollandois, Zellois, et Escohois, sans encourir pour ce en aucune fourfaiture ou amende : et semblablement, pourront faire les Maistres de Neifs et Maronniers de Flandres es Ports et Havres de la Partie d'Angleterre.*<sup>8</sup>

This clause shows already a bilateral form, but the reciprocal favours between the contracting parties were limited to concessions granted to certain specified nations only.

14. By the end of the fifteenth century the stipulations were broadened in the sense that the privileges granted to the beneficiary were no longer restricted to those accorded to certain specifically named countries but extended to favours accorded to any foreign nation. The commercial treaty between England and Brittany of 1486<sup>9</sup> and the Anglo-Danish treaty of 1490<sup>10</sup> have been cited as examples of treaties of this modern type.

### 3. The seventeenth century

15. The use of the clause became common practice during the seventeenth century. It appears in the following form in the treaty of commerce concluded between the Netherlands and Sweden at Nijmegen in 1679:

*The Contracting Parties ad minimum privilegiis, libertatibus, immunitatibus et concessionibus utantur, fruuntur, parique favore in omnibus gaudeant, quibus amicissima quaevis gens extera utitur, fruatur gaudetque aut in posterum uti, frui aut gaudere possit.*<sup>11</sup>

16. The clause appears sometimes in the unilateral form, the more powerful nation assuring for itself, against a more or less important concession, the most-favoured-nation treatment. Thus the treaty concluded between England and Portugal on 29 January 1692, specifies that "subjects of Great Britain shall enjoy all the immunities accorded to the subjects of any nation whatsoever in league with the Portugals".<sup>12</sup>

### 4. Appearance of commercial treaties

17. The modern form of the clause evolved in the eighteenth century, when the phrase "most favored foreign nation" also appeared.<sup>13</sup> Political and commercial treaties became more clearly differentiated. In this respect the example was set at Utrecht in 1713 when, in addition to the political convention between England and France—the core of the peace—a commercial treaty between them was negotiated. This treaty contained a

<sup>8</sup> Quoted by G. Schwarzenberger, *op. cit.*, p. 97.

<sup>9</sup> Quoted by B. Nolde, "Droit et technique des traités de commerce", *Recueil des cours de l'Académie de droit international de La Haye, 1924* (II), t. 3, p. 303, and by S. Basdevant, *op. cit.*, p. 468.

<sup>10</sup> Quoted by G. Schwarzenberger, *op. cit.*, p. 97.

<sup>11</sup> J. Dumont, *Corps universel diplomatique du droit des gens...*, t. VII, part one, p. 439. Quoted by B. Nolde, *op. cit.*, pp. 307-308.

<sup>12</sup> Quoted by 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* (Leyden, Sijthoff, 1969), pp. 19-56.

<sup>13</sup> R. C. Snyder, *The Most-Favored-Nation Clause: An Analysis with Particular Reference to Recent Treaty Practice and Tariffs* (New York, King's Crown Press, Columbia University, 1948), p. 239.

full-fledged most-favoured-nation clause, by which each party guaranteed to the other all advantages conceded or to be conceded to a third State in matters of commerce and navigation.<sup>14</sup> Article 8 of the treaty ran as follows:

It is further agreed and concluded, as a general Rule, That all and singular the Subjects of each Kingdom, shall, in all Countries and Places, on both sides, have and enjoy at least the same Privileges, Libertys, and Immunitys, as to all Dutys, Impositions, or Customs whatsoever, relating to Persons, Goods and Merchandizes, Ships, Freight, Seamen, Navigation and Commerce; and shall have the like Favour in all things as the Subjects of France, or any other foreign Nation, the most favour'd, have, possess and enjoy, or at any time hereafter may have, possess or enjoy.<sup>15</sup>

18. This clause prompted the British Parliament to reject the treaty. An earlier convention concluded between England and Portugal in 1703 had some bearing on this decision: Portugal undertook then to permit the importation of English cloth, and England pledged herself to levy upon Portuguese wines no more than two-thirds of the customs duties imposed upon French wines. The treaty—styled after its English negotiator, Lord Methuen—technically supplemented older treaties of commerce between the two countries. It remained in force for more than a century, deeply influencing Anglo-Portuguese relations, and English foreign policies in general. In fact, the English rejection of the commercial convention of Utrecht was based on the allegation that its most-favoured-nation clause ran counter to the Methuen treaty. It was only in 1786 that a new commercial treaty (the Eden treaty), embodying the most-favoured-nation clause, was entered into by England and France. In the Eden treaty, preferential treatment was reserved for Portuguese imports to England and Spanish imports to France.<sup>16</sup>

### 5. Most-favoured-nation rights acquired in Asia and Turkey

19. In their relations with Asian rulers in the seventeenth and eighteenth centuries the European Powers made efforts to gain markets to the exclusion of others. Where attempts at acquiring a monopoly failed or where they were hopeless *ab initio*, the policy of the Europeans was to obtain most-favoured-nation treatment. Thus the draft treaty submitted by the East India Company to the King of Burma in 1680, proposing free trade and the establishment of factories, stated in article XVII that "if the King shall hereafter grant any more or other privileges to any other nation than what are comprehended in these Articles, the same privileges are to be granted to the English". The Articles of Agreement of 1684 between the Company and the rulers of the West coast of Sumatra stipulated the right of the Company to purchase spices and other goods "at the same prices the Dutch formerly paid". The French East India Company

<sup>14</sup> A. Nussbaum, *op. cit.*, p. 127.

<sup>15</sup> F. L. Israel, ed., *Major Peace Treaties of Modern History 1648-1967* (New York, Chelsea House Publishers, 1967), vol. I, p. 223.

<sup>16</sup> A. Nussbaum, *op. cit.*, p. 127, and B. Nolde, "La clause de la nation la plus favorisée et les tarifs préférentiels", *Recueil des cours de l'Académie de droit international de La Haye, 1932*, t. 39, p. 28.

in 1666 reached an understanding with the Mogul Emperor Aurangzeb who granted it by firman the same privileges as those enjoyed by the English and the Dutch, particularly in relation to the factories in Surat and Soually.<sup>17</sup>

20. A most-favoured-nation clause was often included in capitulations. In the earliest instances it assured the beneficiary of the same advantages as previously granted to certain other nations or towns expressly mentioned. Thus in the Turkish capitulation of 1612 the United Provinces were accorded the same rights as enjoyed by France and England.<sup>18</sup> In the eighteenth century the capitulations contain the clause usually drafted in a very broad form. Thus article 83 of the 1740 French capitulation states: "The privileges and honours granted to the other European nations shall also be granted to the subjects of the Emperor of France."<sup>19</sup>

21. What is today very exceptional and under normal conditions practically non-existent, namely, a unilateral most-favoured-nation clause, was a constant feature of the capitulations. As these in most cases—at least in the earlier periods—took the form of a unilateral grant, the clause included in them was also devoid of reciprocity. This form of the clause was a useful tool in the hands of the European rulers. When one of them succeeded in extorting new concessions for himself and his subjects, the others through the operation of the clause could claim the same advantages for themselves.

22. Thus after the Ottoman Empire was defeated by Russia and its defeat sealed by the Peace of Kuchuk Kainarji in 1774, the peace treaty was followed by a commercial agreement concluded in 1783. This granted Russian subjects the most extensive privileges; but as other nations had protected, or would protect, themselves by most-favoured-nation clauses, their nationals participated in the new concessions. The treaty of 1783 became thereby an important legal document for the foreign commercial relations of the Ottoman Empire.<sup>20</sup>

23. It was not until the French-Turkish Peace Treaty of 1802 that a Western Power concluded a treaty with the Turkish Emperor which contained a reciprocity clause.<sup>21</sup>

24. On the question whether a unilateral most-favoured-nation clause is consistent with the principle of the sovereign equality of States, the case of the Belgian-Chinese commercial treaty of 1865 presents instructive information.<sup>22</sup>

#### 6. The conditional form and the conditional interpretation

25. It was in the eighteenth century that the "conditional" form made its first appearance in the treaty

concluded between France and the United States of America on 6 February 1778. Article II of this treaty was as follows:

The Most Christian King and the United States engage mutually not to grant any particular favour to other nations, in respect of commerce and navigation, which shall not immediately become common to the other Party, who shall enjoy the same favour, freely, if the concession was freely made, or on allowing the same compensation, if the concession was conditional.<sup>23</sup>

It is held that the conditional clause was inserted in the treaty of 1778 at French insistence. Even if it were true that the idea was of French origin, the conditional form of the clause peculiarly suited the political and economic interests of the United States for a long period.<sup>24</sup>

26. The phrase "freely, if the concession was freely made, or on allowing the same compensation [or the equivalent], if the concession was conditional" was the model for practically all commercial treaties of the United States until 1923. Prior to that year, the commercial treaties of the United States contained (with only three exceptions) conditional rather than unconditional pledges on the part of that country.<sup>25</sup>

27. In two of the cases in which the United States negotiated apparently unconditional treaties in this period, i.e. where the treaties did not specifically include the conditional wording of the clause, they were afterwards interpreted as conditional.<sup>26</sup> One such instance was the so-called Louisiana Purchase, the treaty of 30 April 1803 by which France ceded Louisiana to the United States. Article 8 of this treaty provided that "the ships of France shall be treated upon the footing of the most favored nations" in the ports of the ceded territory. By virtue of this provision, the French Government asked in 1817 that the advantages granted to Great Britain in all the ports of the United States should be secured to France in the ports of Louisiana. The advantages accorded to Great Britain were based upon an Act of Congress of 3 March 1815. This Act exempted the vessels of foreign countries from discriminating duties in ports of the United States on condition of a like exemption of American vessels in the ports of such countries. This exemption was granted by Great Britain but not by France, with the result that French vessels continued to pay discriminating duties in the ports of the United States, while British vessels became exempt. The French claim was rejected upon the ground that the clause did not mean that France should enjoy as a free gift

<sup>17</sup> Ch. H. Alexandrowicz, "Treaty and Diplomatic Relations between European and South Asian Powers in the Seventeenth and Eighteenth Centuries", *Recueil des cours de l'Académie de droit international de La Haye*, 1960 (II), t. 100, pp. 207, 270-271.

<sup>18</sup> S. Basdevant, *op. cit.*, p. 468.

<sup>19</sup> *Ibid.* (translation by the United Nations Secretariat).

<sup>20</sup> A. Nussbaum, *op. cit.*, p. 122.

<sup>21</sup> S. Basdevant, *op. cit.*, p. 475.

<sup>22</sup> See paras. 63-64 below.

<sup>23</sup> W. M. Malloy, *Treaties, Conventions, International Acts, Protocols and Agreements between the United States of America and other Powers, 1776-1909* (Washington, Government Printing Office), vol. I, p. 468.

<sup>24</sup> V. G. Setser, "Did Americans Originate the Conditional Most-Favored-Nation Clause?", *The Journal of Modern History* (Chicago, University of Chicago Press), vol. V (September 1933), pp. 319-323.

<sup>25</sup> C. C. Hyde, *International Law Chiefly as Interpreted and Applied by the United States* (Boston, Little, Brown and Co., 1947), 2nd rev. ed., vol. II, p. 1504.

<sup>26</sup> R. C. Snyder, *op. cit.*, p. 244. The third case—where the United States agreed that the clause was truly unconditional—concerned a convention of 1850 with Switzerland. See G. H. Hackworth, *Digest of International Law* (Washington, Government Printing Office, 1943), vol. V, pp. 274-275, 330-331. See also para. 84 below.

that which was conceded to other nations for a full equivalent.

'It is obvious', said Mr. Adams, 'that if French vessels should be admitted into the ports of Louisiana upon the payment of the same duties as the vessels of the United States, they would be treated, not upon the footing of the most-favoured-nation, according to the article in question, but upon a footing more favoured than any other nation; since other nations, with the exception of England, pay higher tonnage duties, and the exemption of English vessels is not a free gift, but a purchase at a fair and equal price.'

France, however, did not concede the correctness of this position and maintained her claim in diplomatic correspondence until 1831, when it was settled by a treaty which practically accepted the American interpretation.<sup>27</sup>

### 7. The era of "free trade"

28. The conditional form of the clause was dominant also in Europe after the Napoleonic period. It has been asserted that perhaps ninety per cent of the clauses written into treaties during the years 1830 to 1860 were conditional in form.<sup>28</sup> The conditional form was virtually abandoned with the conclusion of the treaty of commerce between Great Britain and France of 23 January 1860, often called the Cobden treaty or Chevalier-Cobden treaty after the main English negotiator, Richard Cobden, a passionate advocate of free trade and *laissez-faire*, and his counterpart, Michel Chevalier, the economic adviser to Napoleon III.<sup>29</sup> In this treaty England and France reduced their tariffs very substantially, abolished import prohibitions and granted each other unconditionally the status of a most favoured nation.

29. The Chevalier-Cobden treaty was a signal for the negotiation of many commercial agreements embodying the unconditional clause with a wider scope of application than at any time in its history. A wave of liberal economic sentiment carried the unconditional clause to the height of its effectiveness. From 1860 until the First World War this form of the clause enjoyed its greatest ascendancy and remained the almost universal basis of a vast system of commercial treaties.<sup>30</sup> Within this period, however, during the depression following the Franco-Prussian war, when the transitional growth of protectionism and trade discrimination became prevalent, there was a certain drop in the inclusion of most-favoured-nation clauses in treaties. It is from the pre-war years of the present century that the famous designation of the clause as being "the corner-stone of all modern commercial treaties" originates.<sup>31</sup>

<sup>27</sup> J. B. Moore, *A Digest of International Law* (Washington, Government Printing Office, 1906), vol. 5, pp. 257-260. See also G. W. Wickersham, Rapporteur, Committee of Experts for the Progressive Codification of International Law, Publications of the League of Nations, 1927.V.10 (C.205.M.79.1927.V), p. 7.

<sup>28</sup> L.-E. Visser, "La clause de la nation la plus favorisée dans les traités de commerce", *Revue de droit international et de législation comparée*, Bruxelles, II<sup>e</sup> série, t. IV (1902), pp. 66, 159 and 270. Quoted by R. C. Snyder, *op. cit.*, p. 41.

<sup>29</sup> *British and Foreign State Papers*, vol. 50, p. 13.

<sup>30</sup> R. C. Snyder, *op. cit.*, p. 239.

<sup>31</sup> S. K. Hornbeck, "The Most-Favored-Nation Clause", *American Journal of International Law*, vol. 3, No. 2 (1909), p. 395.

### 8. The war and its effects

30. The outbreak of the First World War not only severed treaty relations between the adversaries but also affected the idea of the most-favoured-nation treatment itself and caused—although temporarily—a retreat in the use of the clause. Throughout the war it was felt that there was something "unnatural" in the effect of the clause, in so far as it required that a State treat close allies and more distant nations in the same manner. In the case of enemies, of course, the operation of the clause can be terminated, but outside this extreme, relations with other States can vary widely from very warm to the frigidity of a near-freezing point.<sup>32</sup>

31. So far as enemies were concerned, the Allied Economic Conference of 1916 agreed that, following the war, those who were the allies' adversaries in that war should be subjected to "systematic discrimination in economic matters...". M. Clementel, the French Minister of Commerce, stated on 15 December 1918: "The Government has denounced all commercial conventions which embody the most-favoured-nation clause. That clause will not reappear. [...] It will never again poison our tariff policy."<sup>33</sup>

32. Other States, however, held the opposite view and believed that economic discrimination had been one of the causes of the war.<sup>34</sup> According to Viner: "... Tariff discriminations are invariably resented by the countries which are discriminated against, and three centuries of experience demonstrate that under all circumstances they operate to poison international relations and to make more difficult the task of maintaining international harmony."<sup>35</sup> This was seemingly the view of President Wilson, who, in the third of his Fourteen Points, spoke out in favour of the removal of trade barriers and the establishment of equality in trade conditions.<sup>36</sup>

33. Such conflicting ideas resulted in compromise solutions such as the pertinent provisions of the Covenant of the League of Nations (Art. 23, para. e)<sup>37</sup> and of the peace treaties of 1919. In these treaties the victorious allies compelled the defeated States to grant them unilaterally the unconditional most-favoured-nation treatment for five years in the case of Germany, and for three years in the case of Austria, Bulgaria and Hungary.<sup>38</sup> A similar position was secured for the allied and associated States in the minorities treaties concluded with Poland, the Serb-Croat-Slovene Kingdom, Czechoslovakia, Romania and Greece in the sense that these States were bound to extend to the allies all favours in customs matters which they might grant within five years to any ex-enemy State.<sup>39</sup>

<sup>32</sup> G. P. Verbit, *op. cit.*, p. 26.

<sup>33</sup> J. Viner, *International Economics* (Glencoe, Ill., Free Press, 1951), p. 95.

<sup>34</sup> G. P. Verbit, *op. cit.*

<sup>35</sup> J. Viner, *op. cit.*, p. 355.

<sup>36</sup> See para. 65 below.

<sup>37</sup> See paras. 65-66 below.

<sup>38</sup> Treaty of Versailles, art. 267; Treaty of Saint-Germain, art. 220; Treaty of Neuilly, art. 150; Treaty of Trianon, art. 203.

<sup>39</sup> League of Nations, *Commercial Policy in the Interwar Period: International Proposals and National Policies*, 1942.II.A.6, p. 15.

### 9. The post-war period

34. In the years after the First World War, the most-favoured-nation clause never regained its former firm position as the general foundation of commercial treaty policy.<sup>40</sup> The destruction of the economy of Europe by four years of war, and the following depression of 1921-1924, with its collapse of currencies and contracting world trade, necessitated the adoption of trade restrictions as a result of which the clause either ceased to operate or could not operate successfully. The widespread reciprocity in trade policies, preoccupation with economic reconstruction and a pronounced opposition to the clause, particularly on the part of France<sup>41</sup> and Spain, prevented or at least slowed down the reappearance of the clause in the immediate post-war period. After a few years of peace, however, with partial recovery and stabilization achieved, the clause again became a common feature of commercial treaties.

35. Italy became the advocate of the unconditional clause as early as 1921, joining forces with the United Kingdom and other traditional upholders of the clause, together with Germany and her ex-allies, to break down the opposition of France and Spain.<sup>42</sup> Soviet Russia appeared on the scene of international trade and beginning with the 1922 Rapallo Treaty concluded a long series of agreements on a most-favoured-nation basis.<sup>43</sup> The United States of America adopted the unconditional clause in 1922. The conditional clause served the purposes of the United States so long as it was a net importer and its primary aim was to protect a growing industrial system. Since the position of the United States in the world economy changed radically after the war, the conditional clause proved to be inadequate. The essential condition for a successful penetration of international markets, i.e., the elimination of discrimination against American products, could only be achieved through the unconditional clause.<sup>44</sup>

36. In consequence of the American move, the conditional form of the clause practically disappeared from the commercial treaties. According to one analyst, of the six hundred and seven most-favoured-nation clauses negotiated between 1920 and 1940, only nine were the conditional type.<sup>45</sup>

37. The year 1927 was of particular importance in the history of the clause. The League of Nations International Economic Conference of that year gave a great impetus to both the use and the study of the clause.<sup>46</sup> France broke with the idea of reciprocity and returned to her pre-war practice by concluding a most-favoured-nation agreement with Germany. Spain adopted the clause by a law passed in 1928. It seemed as if a new period of the general acceptance of the clause had started again. Economists and lawyers dealt with the

problems presented by the application of the clause, and study and research work was undertaken by various bodies of the League.<sup>47</sup>

### 10. The economic crisis

38. In 1929 the great economic crisis broke. It started in the United States of America and swept over the whole world with the notable exception of the Soviet Union, whose national economy, based on socialist ownership of the means of production and on monopoly of foreign trade, was not sensitive to the shocks and troubles of the world market. As a result of the depression international trade declined, differential tariffs arose and destroyed the conditions which premised an efficient operation of most-favoured-nation treatment.<sup>48</sup>

39. By the end of 1931, twenty-six major trading nations had imports and exchange controls, all of which operated in a discriminatory manner.<sup>49</sup> In February 1932, the United Kingdom abandoned its long-standing policy of free trade and enacted a tariff. In the following summer the Imperial Preference System was established. The League of Nations International Convention for the Abolition of Import and Export Prohibitions and Restrictions, done at Geneva, 8 November 1927, which had been brought into operation under a special arrangement in January 1930, between Denmark, Japan, the Netherlands, Norway, Portugal, the United Kingdom and the United States, was denounced by all of these States by the middle of 1934. The foremost proponent and practitioner of discriminatory trade restrictions was Nazi Germany, which regarded the principle of the most-favoured-nation treatment as a particularly vicious offshoot of a discredited *liberalism*.<sup>50</sup> It utilized all kinds of trade controls to make the German economy self-sufficient and provide it with the implements for war.<sup>51</sup> According to the research carried out by Snyder, based upon an analysis of some five hundred and ten bilateral commercial treaties concluded between 1931 and 1939, the most-favoured-nation clause was included in only forty-two per cent of the agreements, whereas according to the same source it appeared in some form in approximately ninety per cent of the commercial agreements negotiated before 1931.<sup>52</sup>

40. Not only did the world economic crisis fail to diminish the interest of lawyers and economists in the most-favoured-nation clause; on the contrary, individual and collective research went on as if it could lead to the solution of the burning problems of the world. The Economic Committee of the League of Nations carried on its work, international conferences (in Stresa and London) dealt with the clause in one form or another, and an abundant literature on the clause flourished in the first half of the 1930s.

<sup>40</sup> R. C. Snyder, *op. cit.*, p. 239.

<sup>41</sup> See para. 31 above.

<sup>42</sup> League of Nations, *op. cit.*, p. 43.

<sup>43</sup> These are dealt with in some detail in paras. 41-52 below.

<sup>44</sup> R. C. Snyder, *op. cit.*, p. 243.

<sup>45</sup> *Ibid.*, p. 41.

<sup>46</sup> See paras. 70-72 below.

<sup>47</sup> See paras. 65-103 below.

<sup>48</sup> R. C. Snyder, *op. cit.*, p. 242.

<sup>49</sup> G. P. Verbit, *op. cit.*, p. 27.

<sup>50</sup> Royal Institute of International Affairs, *Survey of International Affairs, 1938* (London, Oxford University Press, 1941), vol. I, p. 33.

<sup>51</sup> G. P. Verbit, *op. cit.*, p. 27.

<sup>52</sup> R. C. Snyder, *op. cit.*, p. 133.

11. *The clause in the treaties of the USSR*

41. The victory of the October Revolution ushered in a new era by creating the first State built on a socio-economic system different from that of the other members of the community of nations. The young Republic of the Soviets, in its struggle for recognition and economic relations based on equality and non-discrimination, was naturally disposed to avail itself of the old tool of the most-favoured-nation clause. It might be instructive to take a cursory look at the early treaty practice of Soviet Russia, all the more as the application of the most-favoured-nation clauses in commercial treaties concluded between capitalist and socialist States has been often cited as posing specific problems, those connected with the so-called east-west trade, which will have to be considered later.<sup>53</sup>

42. The first economic and commercial conventions of the Republic of the Soviets contain vague formulations of the clause, or rather provisions in order to obtain a normal and non-discriminatory treatment.<sup>54</sup> Thus in the agreement with the United Kingdom of 16 March 1921<sup>55</sup> the Parties pledged "not to exercise any discrimination" against the trade between them "as compared with that carried on with any other foreign country" (art. 1) and undertook that "British and Russian ships, their masters, crews and cargoes shall, [in their ports] receive in all respects, the treatment, privileges, facilities, immunities and protections which are usually accorded by the established practice of commercial nations to foreign merchant ships, their masters, crews and cargoes..." (art. 2).

43. The Treaty of Rapallo concluded with Germany on 16 April 1922,<sup>56</sup> contained, however, a clear stipulation according to which the two Governments agreed "that the establishment of the legal status of those nationals of the one Party, who live within the territory of the other

<sup>53</sup> The main but not exclusive source for this section is the article by E. A. Korovin, "Soviet Treaties and International Law", *American Journal of International Law* [vol. 22, No. 4 (October 1928)], pp. 754-763], and his earlier article on most-favoured-nation clauses in the treaties of the Russian Socialist Federal Soviet Republic in *Sovetskoe pravo* [Soviet Law] 1922, No. 3, pp. 30-41. For an American view of these treaties see J. F. Triska and R. M. Slusser, *The Theory, Law and Policy of Soviet Treaties* (Stanford, Calif., Stanford University Press, 1962), pp. 333-347.

<sup>54</sup> A most-favoured-nation clause had already been included in the short-lived separate peace treaty of Brest-Litovsk of 3 March 1918 (G. F. de Martens, ed., *Nouveau Recueil général de traités et autres actes relatifs aux rapports de droit international*, Continuation du grand recueil de G. F. de Martens, par H. Triepel (Leipzig, Librairie Theodor Weicher, 1921), III<sup>e</sup> série, t. X, p. 773). This clause related to matters of commerce, navigation and rights of citizens.

The treaties of peace with Estonia of 2 February 1920 (League of Nations, *Treaty Series*, vol. 11, p. 51, annex I to article 16), with Lithuania of 12 July 1920 (*ibid.*, vol. 3, p. 122, art. 13 and remark), with Latvia of 11 August 1920 (*ibid.*, vol. 2, p. 212), contained more or less general announcements on most-favoured-nation treatment in commercial relations, whereas the clauses contained in the treaties of peace with Finland and Poland (Finnish treaty of 14 October 1920, *ibid.*, vol. 3, p. 65, art. 32; Polish peace treaty of 18 March 1921, *ibid.*, vol. 6, p. 123, art. 20) pertain only to secondary matters, (E. Sauvignon, "La clause de la nation la plus favorisée" (thesis, Université de Nice, 1968).

<sup>55</sup> League of Nations, *Treaty Series*, vol. 4, p. 127.

<sup>56</sup> *Ibid.*, vol. 19, p. 247.

Party, and the general regulation of mutual commercial and economic relations, shall be effected on the principle of the most favoured nation" (art. 4). The general rule thus established is followed by only one exception: "This principle shall, however, not apply to the privileges and facilities which the Russian Socialist Federal Soviet Republic may grant to a Soviet Republic or to any State which in the past formed part of the former Russian Empire." Article 6 of the treaty provides that "[Article] 4 of this Agreement shall come into force on the day of ratification, and the remaining provisions shall come into force immediately". Korovin remarks in this connexion<sup>57</sup> that the fact that the clause becomes operative only from the day of ratification is "sufficient evidence that this principle [i.e., the principle of the most-favoured-nation treatment] had, prior thereto, been absent".

44. The Danish-Russian preliminary agreement of 23 April 1923<sup>58</sup> which—as pointed out by Korovin—was coincident with the development in Russia of the New Economic Policy (NEP), contains a number of articles promising reciprocal most-favoured-nation treatment in various fields. The clause on trade in general (art. 2) and some others also contain a specific exception:

Art. 2... Trade between the two countries shall not be subjected to other restrictions or other or higher duties than those imposed on the trade with any other country. Denmark shall, however, not be entitled to claim the special rights and privileges accorded by Russia to a country which has recognized or may recognize Russia *de jure* unless Denmark is willing to accord to Russia the corresponding compensations as the country in question...

45. In Korovin's evaluation of the position up to 1924, the USSR "avoided inserting in its treaties any clause of absolute favouredness"—or rather did so only in some individual cases—"wishing to safeguard the largest economic freedom of action in respect of this reservoir of possible concessions, against the day of intense participation by the Soviet State in the economy of world trade".<sup>59</sup>

46. With the development of the New Economic Policy the clause became extensively used and in some treaties covered broad fields. Thus according to the treaty concluded with Italy on 7 February 1924 it applied to the professional activities of the respective citizens, to their legal status, to fiscal regulations, to taxes imposed upon imports etc.<sup>60</sup> In the Convention embodying the basic rules of the relations between Japan and the USSR of 20 January 1925<sup>61</sup> the parties undertook in Article 4 not to apply

in discrimination against the other Party any measures of prohibition, restriction or impost which may serve to hamper the growth of the intercourse, economic or otherwise, between the two countries, it being the intention of both Parties to place the commerce, navigation and industry of each country, as far as possible, on the footing of the most favoured nation.

<sup>57</sup> E. A. Korovin, *op. cit.*, p. 755.

<sup>58</sup> League of Nations, *Treaty Series*, vol. 18, p. 15.

<sup>59</sup> E. A. Korovin, *op. cit.*, p. 757.

<sup>60</sup> *Ibid.*

<sup>61</sup> League of Nations, *Treaty Series*, vol. 34, p. 31.

47. The treaty with Germany of 12 October 1925,<sup>62</sup> based on the Treaty of Rapallo, confirms the general most-favoured-nation principle adopted at Rapallo. It added to the one exception to the clause stated there, the following: (1) frontier traffic (fifteen kilometres); (2) Customs Union; (3) favours granted by the USSR to Persia, Afghanistan and Mongolia; (4) favours granted by the USSR to Turkey and China, in respect to frontier traffic (article 6). The seven agreements included in the treaty covering special fields (Conditions of Residence and Business and Legal Protection, Economic matters, Railways, Navigation, Fiscal questions, Commercial courts of arbitration, and Industrial property) contain detailed regulations also in respect of the level of treatment. Thus in respect of conditions of professional and industrial activities, national treatment and most-favoured-nation treatment—side by side—are the general rule. National treatment is the rule as regards legal aid to the poor. In the economic agreement the parties express their desire to restore trade between their countries to the pre-war level “being guided therein solely by economic considerations” (article 1). Most-favoured-nation treatment is assured in respect of German requests for and holding of concessions granted by the USSR (articles 40 and 41). Reciprocal most-favoured-nation treatment is accorded to goods in transit and to the accompanying persons (article 42). National treatment is the general rule concerning matters of navigation with a combination of a most-favoured-nation pledge (Agreement concerning navigation, article 1). Exceptions are, however:

- (1) Special laws concerning the maintenance, renewal and development of the national fleet;
- (2) Favours granted to the national fisheries;
- (3) Favours granted to athletic associations;
- (4) Navigation between the ports of the other Party situated on the same sea (minor coasting trade, minor cabotage);
- (5) Harbour services (towage, rescue work and salvage) [but duties and charges shall be generally the same for all merchant vessels];
- (6) Pilotage services.

National treatment applies to industrial property in general (Agreement concerning the legal protection of industrial property, article 1).

48. The treaty with Germany was followed by other treaties based on a most-favoured-nation clause concluded with a large number of countries (Norway, Turkey, Persia, Sweden, Iceland and Latvia are mentioned by Korovin).

49. Of particular interest is the temporary commercial agreement concluded with the United Kingdom on 16 April 1930.<sup>63</sup> This contained in article 1 a full-fledged most-favoured-nation clause in respect of rights to trade and to property of natural and legal persons, as well as in respect of “the natural produce and manufactures”

of the Contracting Parties. A protocol annexed to the treaty is worded as follows:

In concluding the present Agreement the Contracting Parties are animated by the intention to eliminate from their economic relations all forms of discrimination. They accordingly agree that, so far as relates to the treatment accorded by each Party to the trade with the other, they will be guided in regard to the purchase and sale of goods, in regard to the employment of shipping and in regard to all similar matters by commercial and financial considerations only and, subject to such considerations, will adopt no legislative or administrative action of such a nature as to place the goods, shipping, trading organizations and trade in general of the other Party in any respect in a position of inferiority as compared with the goods, shipping and trading organizations of any other foreign country.

In accordance with the above principle, trade between the United Kingdom and the Union of Soviet Socialist Republics shall be eligible for consideration on the same basis as trade between the United Kingdom and other foreign countries in connexion with any legislative or administrative measures which are or may be taken by His Majesty's Government in the United Kingdom for the granting of credits to facilitate such trade. That is to say, that in considering any given transaction, regard shall be had to financial and commercial considerations only.

The text of this Protocol apparently served as a basis for the drafting of article XVII, paragraph 1 of the General Agreement on Tariffs and Trade dealing with State trading enterprises.<sup>64</sup>

50. The provisional commercial agreement concluded by the USSR with France on 11 January 1934<sup>65</sup> contains a reciprocal most-favoured-nation clause in respect of the treatment of “French merchants and manufacturers, being natural or legal persons under French law” in the USSR and “Economic organs of State of the Union of Soviet Socialist Republics and Soviet legal persons possessed of civil personality under Soviet law, as also natural persons, being nationals of the Union of Soviet Socialist Republics” in France in the exercise of their economic activities under the conditions authorized by the State of the territory (chap. III, art. 9). Another clause declares that merchant vessels flying the flag of the Contracting Parties, shall be admitted in each other's seaports “under the same conditions in all respects as merchant vessels of the most favoured nation” (chap. III, art. 10). The agreement contains, however, a firm and unilateral pledge of the USSR “to place orders in France for French goods to the value of 250 million francs” within twelve months from the signature of the agreement (chap. II). This is, however, followed by a proviso according to which “It is understood that the prices quoted shall be approximately such as would be obtainable... in the international market for the same quality of goods, and that conditions in respect of interest rates and negotiability by the banks of the bills hereinafter mentioned shall be normal.”<sup>66</sup>

51. Unilateral declarations of the USSR on its intention to make purchases of goods to the amount of \$US30 million and \$US40 million respectively were made in the

<sup>64</sup> E. Sauvignon, *op. cit.*, p. 235.

<sup>65</sup> League of Nations, *Treaty Series*, vol. 167, p. 349.

<sup>66</sup> See Sauvignon's views on this kind of obligation, *op. cit.*, p. 276.

<sup>62</sup> *Ibid.*, vol. 53, p. 85.

<sup>63</sup> *Ibid.*, vol. 101, p. 409.

trade agreements with the United States of July 1935 and August 1937, both embodied in exchanges of notes. In the exchange the United States unilaterally promised most-favoured-nation treatment. This promise is only implicit in the agreement of 1935 but the clause is clearly spelled out in that of 1937. By this clause the United States undertook to

grant to the Union of Soviet Socialist Republics unconditional and unrestricted most-favored-nation treatment in all matters concerning Customs duties and charges of every kind and in the method of levying duties and, further, in all matters concerning the rules, formalities and charges imposed in connexion with the clearing of goods through the Customs, and with respect to all laws or regulations affecting the sale or use of imported goods within the country.<sup>67</sup>

The clause—which then goes further into lengthy details—points to several exceptions. One of them refers to the advantages accorded by the United States to “its territories or possessions”, to the Philippines, to the Panama Canal Zone or to another zone, or to Cuba. Another excepts the operation of the clause from prohibitions or restrictions “(1) imposed on moral or humanitarian grounds, (2) designed to protect human, animal or plant life, (3) relating to prison-made goods, or (4) relating to the enforcement of police or revenue laws”.

52. The main feature of the agreement, however, was its quite exceptional character, inasmuch as the most-favoured-nation pledge bound only the United States without a reciprocal pledge from the USSR.

## 12. *The clause in treaties relating to consuls*

53. Various denoted bilateral treaties of the nineteenth and twentieth centuries (treaties concerning friendship, commerce and navigation establishment, consular matters, legal protection, etc.) deal, in one form or another, with questions of consular relations and consular immunities. Many such treaties contain a most-favoured-nation clause. Although these treaties show a certain diversity in their provisions, it is through their identical and similar provisions, and also through the operation of the clause, that the consular institution has attained a certain degree of uniformity of law and practice. This development made it possible to codify on a world-wide basis important aspects of the law pertaining to consuls in the 1963 Vienna Convention.

54. Mr. Zourek, as Special Rapporteur of the topic of Consular intercourse and immunities, examined in his second report of 30 March 1960,<sup>68</sup> the question whether it was possible and desirable to insert a most-favoured-nation clause in the codification of consular law. In order to answer the question, he considered briefly the essential principles governing the operation of the clause in general and examined in particular its functioning in bilateral treaties pertaining to consular matters.

<sup>67</sup> League of Nations, *Treaty Series*, vol. 162, p. 91 and vol. 182, p. 113.

<sup>68</sup> *Yearbook of the International Law Commission, 1960*, vol. II, document A/CN.4/131, part II, p. 19.

55. With regard to subject-matter, Mr. Zourek's report reveals that the most-favoured-nation clauses refer most often to consular privileges and immunities. Many treaties, and among them the older ones, extend the clause also to the functions of the consuls, though they use different expressions for describing them (powers, functions, duties, competence, rights, attributions etc.). Treaties restricting the operation of the clause to privileges and immunities are also numerous; they denote these variously as prerogatives, exemptions, facilities, etc. Some clauses cover the “treatment accorded to consuls” in general, others refer to special immunities such as non-liability for taxation. A number of treaties contain clauses the scope of which is restricted to the establishment and location of consulates. By these clauses the Contracting Parties grant each other the reciprocal right to establish consulates in ports and towns where the right to appoint consular representatives has been granted to any third State.

56. The report draws attention to the fact that the most-favoured-nation clause in the field of consular relations often appears in conjunction with a reciprocity clause, i.e. the treatment of the most-favoured-nation is accorded “subject to reciprocity”. This may denote—according to Mr. Zourek—an abstract or formal reciprocity, or else a material reciprocity. The difference between these two notions is explained as follows:

Under a formal reciprocity, identity of treatment in a particular sphere is guaranteed but not necessarily identity of advantages in a specific case, as for example where one of the two States grants to a third State national treatment in some particular aspect. Material reciprocity, on the other hand, entitles a State to claim for itself, its representatives, nationals, ships and products, the same effective treatment as it grants in its territory to the other State, even though, in the case in question, the grantor State does not discriminate between the nationals of the beneficiary State and the nationals of other foreign States.<sup>69</sup>

57. It has been pointed out that the practice of referring to reciprocity in most-favoured-nation clauses has become widespread. In addition, the reference to reciprocity is sometimes more explicit as, for example, in the following clause in article 14 of the Italo-Turkish Consular Convention of 9 September 1929.<sup>70</sup>

The Consular officials of each of the High Contracting Parties shall further enjoy, subject to reciprocity, in the territory of the other Party, the same privileges and immunities as the Consular officials of any third Party of the same character and rank, so long as the latter enjoy such privileges.

The High Contracting Parties agree that neither of them shall be entitled to appeal to the advantages under a Convention with a third Party in order to claim for its Consular officials privileges or immunities other or more extended than those granted by the Party itself to the Consular officials of the other Party.

58. It is submitted in this connexion that a reference to reciprocity in a most-favoured-nation clause changes the formal reciprocity of an unconditional clause into a material one, i.e., subjects the operation of the clause to a condition—namely, that of a materially reciprocal

<sup>69</sup> *Ibid.*, pp. 20-21, para. 13.

<sup>70</sup> League of Nations, *Treaty Series*, vol. 129, p. 195.

treatment in specified cases. Thus we are confronted with a simplified form of a conditional clause. This is certainly not exactly the same as the classical form of a conditional clause ("freely, if the concession was freely made..." etc.),<sup>71</sup> but it still hampers the automatic application of the clause, which is the main feature of its unconditional form. When the clause pertains to consular immunities, a reciprocity clause operates smoothly in most cases because the material identity of, or difference in, the reciprocal advantages can easily be established. The position may become more complicated if the clause refers to consular functions, for the dissimilarity of the national laws, in the sphere of which the consul works, can make a comparison between the respective positions of the consuls concerned extremely difficult.

59. Although the classical form of the conditional clause appeared in very few treaties relating to consuls, the conditional interpretation of the most-favoured-nation clause still prevails in the practice of the United States, inasmuch as most-favoured-nation treatment is subject to materially reciprocal treatment being accorded by the country invoking the provision.<sup>72</sup>

### 13. *The practice of the Permanent Court of International Justice*

60. The Permanent Court of International Justice dealt only incidentally with the clause in its advisory opinion of 7 February 1923 on the *Nationality Decrees issued in Tunis and Morocco (French zone)*.<sup>73</sup> In the dispute between Great Britain and France, in regard to which the Council of the League of Nations requested the advisory opinion of the Court, Great Britain relied *inter alia* upon a most-favoured-nation clause contained in an arrangement of 1897 and an exchange of notes supplementing it. By these instruments the French Government undertook not to accord to the subjects, protected persons or merchandise of a third Power any treatment in Tunis which should not be effectively applicable to the subjects, protected persons and merchandise of the United Kingdom. By a consular convention concluded between France and Italy in 1896 it was provided that Italians in Tunis should be exempt from obligatory military service as well in the army as in the navy, the national guard or the militia.

61. It was the British contention that, by reason of the terms introduced into the Anglo-French arrangement of 1897 and the exchange of notes in 1919, the French Government was bound to accord to British subjects in Tunis treatment not less favourable than that accorded to Italian subjects in Tunis by the consular convention of 1896. The French Government, however, denied that the most-favoured-nation clause relied upon by Great Britain was applicable in this case, first, because of the exclusively economic bearing of the clause and, second,

because of the synallagmatic character of the Franco-Italian convention which had been concluded in the interest of the two Contracting Parties, and not to place one of them in an advantageous position.<sup>74</sup>

62. The Court was not in a position to decide the question because it was only requested to give an advisory opinion whether the dispute between France and Great Britain as to certain nationality decrees issued in Tunis and Morocco (French zone) on 8 November 1921, and their application to British subjects, "is or is not by international law solely a matter of domestic jurisdiction". The Court found that the issue did not concern a matter solely within the domestic jurisdiction of France. The matter was settled later by agreement.<sup>75</sup>

63. The question whether a treaty containing unilateral most-favoured-nation clauses could be considered consistent with the principle of sovereign equality of States played a certain role in the conflict between China and Belgium in the 1920s. The Government of China notified the Government of Belgium on 16 April 1926 that it considered the Sino-Belgian Treaty of Amity, Commerce and Navigation of 2 November 1865, would terminate on 27 October 1926. The treaty in question contained a most-favoured-nation pledge by China in respect of privileges and immunities of Belgian consuls (art. 7), and of customs duties to be paid by Belgian merchants on imported and exported goods (art. 30), and a clause in which China generally accorded "to Belgium and the Belgians full and equal participation in all privileges, immunities and advantages which have been accorded or will henceforth be conceded by His Majesty the Emperor of China to the Government or the subjects of any other nation..." (art. 45). The Government of Belgium did not recognize the right of China to terminate the treaty. In the course of the ensuing negotiations a possible *modus vivendi* was envisaged, but ultimately no agreement was reached.<sup>76</sup> The Belgian Government brought the case before the Permanent Court of International Justice, but the Chinese Government refused to participate in the proceedings. The Chinese Ministry of Foreign Affairs published a statement of the Chinese Government which ran partly as follows:

... The "unequal treaties" which were exacted from China nearly a century ago have established between Chinese and foreigners discriminations that are now sources of endless discontent and friction with foreign Powers. Such a state of affairs is not as it should be, since intercourse between nations, as between individuals, finds its rational *motif* in the exchange of mutual benefits which will endure and lead to lasting friendship. In an age which has witnessed the coming into existence of the League of Nations and the birth of the "spirit of Locarno", there does not seem to be any valid reason to justify international relations which are not founded on equality and mutuality. Reciprocity engenders mutual confidence which, in turn, promotes goodwill and understanding.

To attain this desire, the Chinese Government have repeatedly sought through diplomatic channels and international conferences to put an end to the unequal clauses contained in China's treaties with the Powers which seriously restrict the free exercise of her legitimate rights in such important matters as customs tariff,

<sup>71</sup> See paras. 25-27 above.

<sup>72</sup> C. C. Hyde, *op. cit.*, p. 1513, and Kearney in the 976th meeting of the International Law Commission (*Yearbook of the International Law Commission*, 1968, vol. I, p. 186, para. 8).

<sup>73</sup> *P.C.I.J.*, Series B, No. 4.

<sup>74</sup> *Ibid.*, pp. 15, 30-31.

<sup>75</sup> League of Nations, *Treaty Series*, vol. 18, p. 305.

<sup>76</sup> *P.C.I.J.*, Series C, No. 16-I, pp. 14-16 and 25-36.

jurisdiction over foreign nationals, etc. These provisions create unilateral rights and derogate from China's sovereignty; they impede the development of her international relations and hamper her political and economic life. Consequently, the Chinese Government have, on the one hand, raised the question of revision of China's unequal treaties at Versailles and Washington as well as at the Special Conference on the Chinese Customs Tariff in Peking and, on the other hand, have consistently refrained from concluding new treaties unless they were based on equality, reciprocity and mutual respect for territorial sovereignty. Treaties on this new basis have been steadily growing in number: they now include those with Austria, Bolivia, Chile, Finland, Germany, Persia and the Union of Soviet Socialist Republics.

... The Chinese Government, therefore, communicated to the Belgian Government on April 16th, 1926, their desire to terminate the Sino-Belgian Treaty on 27 October 1926, in its present form, and proposed to commence negotiations at the earliest possible date for the conclusion of a new treaty [...]

After lengthy negotiations, however, the two Governments agreed to terminate the Treaty of 1865 and adopt in its stead a provisional *modus vivendi* according reciprocally the most-favoured-nation treatment to the diplomatic and consular agents, citizens, juridical persons, products and vessels of each country in the territory of the other and agreeing to conclude a new treaty on the basis of equality and mutual respect for territorial sovereignty [...]

(The statement then describes the unsuccessful negotiations between the two Governments and declares that the Chinese Government had no alternative but to terminate the Treaty of 1865 unilaterally.)<sup>77</sup>

64. The views of the Belgian Government on this point were set forth by the agents of the Government as follows:

...

(2) The principle of the legal equality of States.

The Chinese Government seems to attach great importance to the principle of the legal equality of States. The Belgian Government fully appreciates the value of this rule of law in the relations between States when international conventions are silent, but it cannot admit that the validity of special arrangements which have been freely agreed to by States in connexion with particular situations can be called into question in the name of that principle.<sup>78</sup>

The Belgian Government ultimately withdrew its request and hence the matter was not decided by the Court.<sup>79</sup>

## CHAPTER II

### Attempts at codification under the aegis and in the era of the League of Nations

#### 1. *The Covenant of the League of Nations*

65. In the time of the League of Nations the problem of the most-favoured-nation clause was for a long period of prime interest to economists and it served also as

<sup>77</sup> *P.C.I.J.*, Series C, No. 16-I, pp. 271-276.

<sup>78</sup> *Ibid.*, p. 22 (translation by the United Nations Secretariat).

<sup>79</sup> *Ibid.*, Series A, No. 18/19, p. 5; K. Marek, H. P. Furrer and A. Martin, *Répertoire des décisions et des documents de la procédure écrite et orale de la Cour permanente de Justice internationale et de la Cour internationale de Justice* (Geneva, Publications de l'Institut universitaire de Hautes Etudes internationales), No. 47, series I, vol. 2, 1967, pp. 155-158.

a topic of important legal studies. Article 23, paragraph *e*, of the Covenant of the League of Nations has its origin in the third of the fourteen points of the American President, Woodrow Wilson. In this he proposed the "removal so far as possible of all economic barriers and the establishment of an equality of trade conditions among all nations consenting to the peace and associating themselves for its maintenance". In his third draft of the Covenant submitted to the Paris Peace Conference he formulated this idea as follows:

It is further covenanted and agreed by the Contracting Powers that in their fiscal and economic regulations and policy no discrimination shall be made between one nation and another among those with which they have commercial and financial dealings.

66. Article 23, paragraph *e*, of the Covenant is but a watered-down version of this proposal. It establishes the principle of "equitable treatment of the commerce of all Members of the League" subject to and in accordance with "the provisions of international conventions existing or hereafter to be agreed by the Members of the League". This is supplemented by a reference to "the special necessities of the regions devastated during the war".<sup>80</sup> By virtue of this provision the League considered one of its main aims to be the reorganization of a world economy disrupted by the ravages of the First World War. A series of international economic conferences was believed to serve the purpose, which was of course the main concern of the Economic Committee of the League of Nations.

#### 2. *The International Economic Conference (Genoa, 1922)*

67. The memorable international economic conference held at Genoa in 1922—memorable because "the study of the Russian problem played a primordial role in it"<sup>81</sup>—adopted a report of its Economic Commission which included a recommendation on treaties of commerce running as follows:

##### *Article 9*

The Conference recalls the principle of the equitable treatment of commerce set out in article 23 of the Covenant of the League of Nations, and earnestly recommends that commercial relations should be resumed upon the basis of commercial treaties, resting on the one hand upon the system of reciprocity adapted to special circumstances, and containing on the other hand, so far as possible, the most-favoured-nation clause.

[Two notes, reading as follows, were appended to article 9:]

*Note 1.*—The majority of the countries represented on the Commission, while recognizing the temporary difficulties which may

<sup>80</sup> An important gloss was placed on the terms of Article 23 paragraph *e*, to the effect that the reference to the "commerce of Members of the League" gave no countenance, in the opinion of the Economic Committee of the League of Nations Assembly, to discrimination as between Members and non-Members as such. This position has been consistently maintained. See League of Nations Publications, 1942.II.A.6, p. 25.

<sup>81</sup> France, Ministère des affaires étrangères, *Conférence économique internationale de Gènes (9 avril-19 mai 1922)—Documents diplomatiques* (Paris, Imprimerie Nationale, 1922), p. 144.

preclude the general adoption of the most-favoured-nation treatment, declare that this is the goal at which they should aim.

*Note 2.*—The majority of the States also declare that it is desirable that the States should not bind themselves in any commercial treaties which they may make either among themselves or with other States, by any stipulation which would prevent the extension to other States of reductions of customs duties or customs facilities accorded by one to another.<sup>82</sup>

68. The formulation of article 9 and of the notes smacks of compromise. Indeed, the reasons why the recommendation was so vague and why no unanimity was reached were given in the report on the results of the technical commission as follows:

... the German delegation submitted a draft providing for the reciprocal and immediate granting, by all nations, of the most-favoured-nation clause in the matter of tariffs. Its aim, which was scarcely concealed, was to make us abandon, as the result of a wish expressed by an International Conference, the unilateral advantages we derive from articles 264 to 267 of the Treaty of Versailles. [<sup>83</sup>] These articles, which are to remain in effect for five years and may subsequently be maintained by the League of Nations by virtue of article 280 of that Treaty, are motivated by the fact that it is impossible for France to admit the products of German industry to its territory on the same conditions as the products of other countries, owing to the lead taken by that industry during the war. The Japanese, British and Italian delegations, while stating that they respected existing treaties, enthusiastically supported the principle underlying the German proposal. In particular, the statement which the French delegation made after having set aside the German proposal through an interlocutory motion, led the Swiss delegation to submit a compromise text on the principle of the most-favoured-nation clause, which was adopted.

This text [...] states [...] that these bilateral treaties should be based not on the principle of equal commercial conditions, which is usually expressed by the most-favoured-nation clause, but on the principle of the equitable treatment of commerce. Only in an appended note is it stated that the majority of the States represented on the Commission, while recognizing the current difficulties which may preclude the general application of the most-favoured-nation clause, declare that that is the goal at which they should aim. However, the very form of the note implies that this majority has given up the idea of imposing its system; immediate and general application cannot be recommended in view of the present situation in Europe.<sup>84</sup>

69. The Economic Commission of the Genoa Conference dealt also with the treatment of foreign persons and companies engaged in business. It recommended, in matters of taxation, national treatment as a general rule. If in exceptional cases public interest made a derogation from the general rule necessary, such derogations were to apply equally to all foreigners without distinction as to their nationality.<sup>85</sup>

### 3. *The International Economic Conference (Geneva, 1927)*

70. The International Economic Conference held at Geneva in May 1927 under the auspices of the League of Nations discussed in greater detail the problems of

international trade and adopted recommendations on the most-favoured-nation clause. These have given a great impetus for further studies of the clause.

71. The recommendations of the 1927 Conference read as follows:

(1) The Conference therefore considers that the mutual grant of unconditional most-favoured-nation treatment as regards customs duties and conditions of trading is an essential condition of the free and healthy development of commerce between States, and that it is highly desirable in the interest of stability and security for trade that this treatment should be guaranteed for a sufficient period by means of commercial treaties.

(2) While recognizing that each State must judge in what cases and to what extent this fundamental guarantee should be embodied in any particular treaty, the Conference strongly recommends that the scope and form of the most-favoured-nation clause should be of the widest and most liberal character and that it should not be weakened or narrowed either by express provisions or by interpretation.

(3) The Conference recommends that the Council of the League of Nations should entrust the Economic Organisation to undertake, in connection with the inquiry provided for in the preceding recommendations, all the necessary discussions, consultations and enquiries to enable it to propose the measures best calculated to secure either identical tariff systems in the various European countries or at least a common basis for commercial treaties, as well as the establishment, for all countries, of clearly defined and uniform principles as to the interpretation and scope of the most-favoured-nation clause in regard to customs duties and other charges.

(4) The Conference, however, considers that the fact that certain discussions, consultations and enquiries may be taking place as contemplated in these recommendations should not in any way be permitted to retard commercial negotiations, now pending or to dissuade States from entering upon such negotiations.<sup>86</sup>

72. On 16 June 1927 the Council of the League instructed the Economic Committee to examine the recommendations of the International Economic Conference and this instruction was subsequently confirmed by the Assembly on 24 September 1927.

#### 4. *The work of the Economic Committee of the League of Nations Assembly*

73. In pursuance of the relevant resolution of the Assembly the Economic Committee in the course of its twenty-third session drew up a programme of its work. The Committee stated in its report *inter alia* that "its main work must be to carry out the commercial policy advocated by the" International Economic Conference of 1927. According to the report, the outstanding result of this Conference was "the new orientation of commercial policy towards a liberal and equitable régime of trade". The report repeats the affirmation of a liberal commercial policy of which the Committee "feels itself to be the chosen advocate". The report continues:

The Committee accordingly decided to attempt to devise treaty-making methods by which a general reduction of tariffs could gradually be effected and their stability ensured, and which would encourage the conclusion of bilateral conventions affording the

<sup>82</sup> *Ibid.*, pp. 162 and 163.

<sup>83</sup> See para. 33 above.

<sup>84</sup> France, Ministère des affaires étrangères, *op. cit.*, p. 145.

<sup>85</sup> *Ibid.*, p. 164 (rapport de la Commission économique, art. 15).

<sup>86</sup> League of Nations, document C.356.M.129.1927.II (C.E.I.46), p. 43.

contracting States equal commercial opportunities and establishing their trade on a footing that would make it impossible to dig pitfalls for other countries.

The Committee has conducted this technical investigation in the conviction that the adoption of the solutions to which it will lead may very greatly improve the position of international trade and become a determining factor in the pacification of international commercial relations [...]. With this intention the Committee, in compliance with a particularly explicit recommendation of the Conference, has undertaken to codify most-favoured-nation treatment, which should be either the central principle or the normal outcome of every commercial negotiation. [The Committee would soon furnish particulars], which might serve as a basis for international engagements, with regard to its mechanism, its scope, and its bearing on multilateral conventions. [The Committee also envisaged the] examination of those general, special and geographical exceptions of which the introduction seems desirable on account of established international practice or the peculiar circumstances of certain States. [Finally, the Committee expressed its conviction that] well-considered action in the matter of commercial conventions based on the most-favoured-nation clause must speedily bring about the re-establishment of regular currents of trade, which will no longer have to contend with a policy of protectionism and isolation.<sup>87</sup>

74. Based on this programme, adopted in the spirit of the then-fashionable liberalism, the Committee carried out its inquiry with regard to most-favoured-nation treatment in the sphere of tariffs and trade. It drafted a model clause, and examined the problems of interpretation and application and those of the relations between bilateral agreements based on the clause and plurilateral—as they then were called—economic conventions. The Committee's doctrine in regard to all these matters formed the subject of three separate reports submitted to the Council of the League of Nations in 1928 and 1929.<sup>88</sup>

75. In 1930 the Economic Committee resumed its study of the most-favoured-nation clause. At that point it considered the compatibility of Customs quotas and anti-dumping and countervailing duties with the most-favoured-nation clause, the interpretation of the expression "like products" for the purposes of the application of the clause and, lastly, the question of the nationality of goods. The results of these latter investigations were embodied in the report to the Council of the League of Nations.<sup>89</sup> In this the Committee took care to emphasize that

... it had no intention of interpreting a particular formula of the most-favoured-nation clause, since this clause occurs in different forms, but that it had endeavoured to define the *general principles of most-favoured-nation treatment*.

76. In 1933, the Secretariat of the League of Nations thought it advisable to amalgamate in a single paper<sup>90</sup> the conclusions of the Committee's earlier and later investigations with regard to the most-favoured-nation clause.

<sup>87</sup> League of Nations, document C.666.M.224.1927.II, pp. 2-3.

<sup>88</sup> *Id.*, documents C.357.M.111.1928.II, pp. 3-5; C.20.M.14.1929.II, pp. 2 and 5-12; C.155.M.61.1929.II, pp. 1-2.

<sup>89</sup> *Id.*, document C.427.M.177.1931.II.B, pp. 2-3, 7-13.

<sup>90</sup> *Id.*, document E.805.1933.II.B.1, reproduced in the League of Nations publication *Commercial Policy in the Post-War World* (C.31.M.31.1945.II.A.7), Annex I.

77. In 1936, the Economic Committee again devoted long consideration to "the question of equality of treatment in international economic relations which it is the object of the most-favoured-nation clause included in commercial treaties to ensure". On this occasion the Committee was faced with the problems raised by the world-wide depression and by new phenomena, such as foreign exchange control, clearing arrangements and the like which it then called "temporary disturbances of the economic mechanism". The results of its renewed studies were embodied in a detailed report, entitled "Equality of treatment in the present state of international commercial relations: The most-favoured-nation clause".<sup>91</sup>

78. Even if the doctrine of the Economic Committee is almost entirely restricted to the application of the clause in Customs matters and, in some parts, may be considered obsolete today, it contains elements which cannot be bypassed in the course of a modern codification of the clause. The Special Rapporteur thinks it useful therefore to present in annex I to the present report excerpts from the two papers mentioned in paragraphs 76 and 77 above, believing that these excerpts—or at least some of them—may have legal relevance to the formulation of the rules to be adopted in the course of codification.

#### 5. *The work of the Committee of Experts for the Progressive Codification of International Law*

79. The "progressive codification of international law" undertaken by the League of Nations originated in a resolution of the Assembly adopted on 22 September 1924. The Committee of Experts convened in pursuance of this resolution had the duty to prepare a list of subjects which it considered "sufficiently ripe" for codification. Among the subjects to be examined for this purpose it selected also the most-favoured-nation clause and appointed a Sub-Committee, which had to consider the following question:

If it be possible, and in what degree, to reach an international agreement concerning the principal means of determining and interpreting the effects of the most-favoured-nation clause in treaties.

The sub-committee was composed of Mr. George W. Wickersham, former Attorney-General of the United States, as Rapporteur, and Professor Barbosa de Magalhães of Portugal.

80. The report of Mr. Wickersham<sup>92</sup> began with the indication that his attention was directed to the clause as it appears in commercial treaties. The report then gave an explanation on the meaning of national treatment on the one hand and most-favoured-nation treatment on the other. It quoted examples of most-favoured-nation clauses, arranging them in the following classes: unconditional, conditional, unlimited, limited and irregular forms.

<sup>91</sup> *Id.*, document C.379.M.250.1936.II.B, pp. 2 and 5.

<sup>92</sup> Publications of the League of Nations, 1927.V.10. (C.205.M.79.1927.V).

(a) *Field of application of the clause*

81. On the question of the subjects to which the clause may be applied the report had this to say:

It may be stated broadly that the clause may apply to every right, privilege or immunity which the State grants in its public capacity, but not to private rights or privileges which it grants as an individual. For instance, France may claim for her subjects the privilege granted to British subjects to import certain articles at lower tariff rates, or to hold land in the United States, or to maintain suits in the American courts, or to maintain a residence in the United States. But she could not claim the right to share a contract of the United States Government with a British company for the furnishing of material, or in a grant of public lands to a British subject.

The favours embraced in the most-favoured-nation clause are those which a State may grant in its governmental, as distinguished from its business, activities.

Provisions in commercial treaties may be as wide and diversified as the objects, interests, activities and instruments of commerce and industry in all their phases, so as to protect the rights and interests of nations and individuals participating in "commercial and industrial development on an international scale".

Bearing in mind that any favour which a State may grant as a public right may be claimed under an unlimited most-favoured-nation clause, *it would be idle to attempt a list of subjects which are or may be subject to most-favoured-nation treatment.*<sup>93, 94</sup>

(b) *Duration of the privilege*

82. On the question of the duration of the privilege granted by the clause, the report accepted the view according to which the right to the favour accorded by the clause is wholly dependent upon the primary right, and stands or falls with it.

(c) *Future favours*

83. The report agreed with the view of those (and it believed that they were in the majority) who considered that the clause applied to all favours, past and future, even in the case that this was not specifically so provided.

(d) *Conditional and unconditional interpretation*

84. The report related two cases to demonstrate that the United States was inclined to interpret the most-favoured-nation clause as conditional even if its wording would not clearly indicate a condition. It quoted one instance when the United States was bound to admit that an unconditional operation was intended by the negotiators of the treaty (concluded with Switzerland in 1850) but at the same time announced that this was to be considered as an exception to the American practice and steps were taken to terminate the treaty.

(e) *Violations of the clause*

85. The report then considered the "attempts to avoid effects of the clause", classifying these as follows:

(i) *The minute classification of articles in tariff schedules*

The following examples were given:

The imposition of one rate of duty on black oils and another and heavier one on yellow oils. . . . On its face there is no discrimination;

<sup>93</sup> Italics supplied by the Special Rapporteur.

<sup>94</sup> Publications of the League of Nations, 1927.V.10 (C.205.M.79.1927.V), p. 6.

all nations are treated equally, and the only requisite for the lower duty is that the oil be black. One must know that all Russian oils are black and that most American oils yellow to get the true purpose of the provision.

As another classic example of such a condition, item 103 of the German Tariff of 1902 was cited. It provided a very low special rate on

Large dappled mountain cattle reared at a spot at least 300 metres above sea-level, and which have at least one month's grazing each year at a spot at least 800 metres above sea-level. . . . Brown cattle are those breeds which. . . belonging to the long-headed variety, especially to the races of Alpine cattle. . . have a silver-grey to dark or very dark-brown hide, with lead-coloured muzzle, bordered with very light brown, almost white; black hooves and horn tips, and dark tail tuft.

This provision admitted cattle from Switzerland and the Austrian Tyrol, while effectively shutting out French, Belgian, Dutch, Danish and Russian cattle. Yet, so far as language goes, the favour was open to all nations.

86. The report pointed out that conditions which were perfectly proper shaded off imperceptibly into restrictions and descriptions which were, without question, in violation of the spirit—and usually in violation of the letter—of the clause. For the example given—"black oils"—it was not very far to such illogical and impossible tariff conditions as "goods imported by railway [. . .], salt from a country which imposes no duty on salt [. . .], products from countries whose tariff schedule the President deems unreasonable" or from "monarchies whose rulers have blue eyes".<sup>95</sup>

(ii) *Geographical discriminations*

87. The controversy between the United States and Norway in 1828 over a discrimination in the tonnage tax imposed by the latter on vessels coming from European ports and on those coming from ports not European, was quoted in the report as an example of an effort to avoid the effect of the most-favoured-nation clause. Another example was the provision of the United States Navigation Act of 1884, which imposed a lower tonnage tax on vessels coming from certain American ports and a higher one on those coming from other ports. This gave rise to protests on the part of States having treaties with the United States containing most-favoured-nation clauses.

(iii) *Imposition of countervailing duties*

88. Certain countries adopted the system of paying bonuses to encourage particular industries, first, to stimulate production and, secondly, to enable the products to be sold in foreign markets in successful competition with domestic products in those markets. Arguments were advanced for and against the compatibility of the countervailing duties with the most-favoured-nation clause. According to Mr. Wickersham, countervailing duties would seem in the view of the experts to be against the principle of most-favoured-nation treatment, but there appeared to be an overwhelming necessity for something of the kind to stop "dumping". Consequently, he thought that countervailing duties were permissible,

<sup>95</sup> *Ibid.*, p. 9.

even though they were in technical violation of the clause, if they were used justly and as a matter of necessity. The arguments advanced to sustain the practice in general were merely *ex necessitate*. The Rapporteur added that the following line of argument would probably be more convincing than any other: namely, where a higher duty was imposed upon goods coming from a country which paid bounties for their production than upon the products of other countries, far from constituting a discrimination contrary to the treaty provision, the countervailing duty was a means of protecting against such discrimination. But this argument was sound only when such a duty was actually necessary to equalize conditions.

(iv) *Imposition of sanitary prohibitions*

89. The quarantine on cattle from districts where there was foot-and-mouth disease, the prohibition on the importation of Japanese silkworms, because they carried a dangerous parasite, or the prohibition of the importation of opium, were examples of justified prohibitions, such as no nation would claim to be in violation of its most-favoured-nation clause. It had never been doubted that a nation might impose sanitary embargoes, but some restrictions ought to be placed on nations in this respect so as to avoid wanton discrimination.

(f) *Conclusions of Mr. Wickersham*

90. Lastly the report gave a brief summary of the history of the clause as it was affected by the First World War. It recalled the changes in the policy of the United States of America which occurred through the adoption of the "open door" theory and correspondingly through the inclusion of unconditional clauses in the commercial treaties. It quoted the text of an elaborate most-favoured-nation clause as it appeared in the German-American commercial treaty of 1924. Emphasizing the necessity of drafting treaties in such a way as to make the intention of the parties perfectly clear, the report of Mr. Wickersham concluded that a negative answer must be given to the original question put to the Sub-Committee: "it would not seem either necessary or desirable even if it were practicable to endeavour to frame a code provision to govern the case".<sup>96</sup>

91. In case of disputes as to the interpretation of most-favoured-nation clauses Mr. Wickersham recommended a reference to "one of The Hague tribunals".

92. He was also not convinced of the necessity of having special substantive rules of interpretation in regard to the clause. "The ordinary rules of judicial interpretation would seem adequate and more desirable"—the report concluded.<sup>97</sup>

(g) *The contrary view*

93. The second member of the Sub-Committee, Professor Barbosa de Magalhães, made his observations verbally<sup>98</sup> and came to different conclusions from those of his colleague. He believed that "it was not only

desirable, but possible to reach international agreement" in regard to the rules governing the clause and "he saw no legal, and more particularly no political obstacles in the way". Such rules, "which should be framed [...] in harmony with settled practice, would prove very useful to economic interests".<sup>99</sup>

(h) *Questions to be regulated*

94. The questions which might be regulated by means of a general convention could be, according to Professor Barbosa de Magalhães, *inter alia* the following:

... Should the clause cover favours granted to third parties prior to the convention, as well as favours subsequent to the conclusion of the convention? Should the equality of rights have the same period of duration as the clause itself? Did the favours granted subsist or fall with the conventions concluded with third parties? What were the third parties whose rights were included in the clause? Should it cover all foreign States, including their dominions or protectorates, with the exception of those with which the contracting party had concluded a customs union? Did it follow that colonies could not be regarded as third parties from the point of view of the application of the clause?<sup>100</sup>

Professor Magalhães thought that all these questions should be answered in the affirmative. As to the question whether the clause, in the absence of a clear and explicit stipulation, should be regarded as conditional or unconditional, he opted for the second alternative.

(i) *Rules of interpretation*

95. He believed, in contrast to Mr. Wickersham, that

The ordinary rules of judicial interpretation did not suffice to prevent disputes between the contracting States; that it was desirable to frame supplementary provisions in a general international convention [...]. It would be better [...] to lay down certain general rules [...] which, being purely of a supplementary character and devoid of any binding force as regards the use of the clause, its application, its form or its scope, would be of great value for the guidance of States by determining the interpretation, meaning, scope and application of the clause when it was not clearly expressed.<sup>101</sup>

(j) *Conclusion of Professor Barbosa de Magalhães*

96. In conclusion Professor Magalhães thought that the subject, which was such as to allow of the regulation by an international convention of at least certain problems, should not be dropped and that it ought to be submitted to Governments, either with a draft convention or a questionnaire.

(k) *The decision of the Committee of Experts*

97. As is commonly known, however, the Committee of Experts for the Progressive Codification of International Law found on balance, at its third session held in 1927, that "the international regulation of these questions by way of a general convention, even if desirable, would encounter serious obstacles" and it did not place the topic on the list of those topics which it recommended for codification.<sup>102</sup>

<sup>96</sup> Publications of the League of Nations, 1927.V.10 (C.205.M.79.1927.V), p. 14.

<sup>97</sup> *Ibid.*

<sup>98</sup> *Ibid.*, pp. 14-15.

<sup>99</sup> *Ibid.*, p. 15.

<sup>100</sup> *Ibid.*, p. 14.

<sup>101</sup> *Ibid.*, p. 15.

<sup>102</sup> *Ibid.*, p. 1.

6. *The World Monetary and Economic Conference*  
(London, 1933)

98. The problem of the most-favoured-nation clause was also in the forefront of the deliberations of the World Monetary and Economic Conference convened by the Council of the League of Nations in London in 1933. Its task was to decide upon "measures necessary to solve the [...] economic and financial difficulties which are responsible for, and may prolong, the present world crisis".

99. The machinery set up by the Council included a Preparatory Commission of Experts. The Commission prepared a draft annotated agenda of the Conference. In their report<sup>108</sup> the experts, after an introduction giving a short but graphic picture of the ravages of the economic crisis of the period, commented in detail on the various items to be dealt with by the Conference: monetary and credit policy, prices, resumption of the movement of capital, restrictions on international trade, tariff and treaty policy, and organization of production and trade. Under the heading "Tariff and treaty policy" the report devoted a special section to the most-favoured-nation clause which, the experts considered, should constitute, under normal conditions and in its unconditional and unrestricted form, the basis of commercial relations between nations. Accordingly, the experts recommended:

That the Conference should reach an agreement at any rate as to the scope of the most-favoured-nation clause, if not as to its precise form.

It will be desirable... to reach an agreement in regard to the more important questions connected with the application of this clause, such as customs quotas, the excessive specialization of tariffs, dumping and anti-dumping measures, the nationality of goods, "like" products, and, until such time as all restrictions on currency are abolished, [104] exchange restrictions and compensation and clearing agreements.

It will also be desirable to reach an agreement regarding the exceptions to the clause which may be deemed necessary.<sup>105</sup>

100. The report distinguished between permanent exceptions, such as frontier traffic, customs unions, etc., and temporary ones. In connexion with the former it raised the question whether a new permanent exception should be admitted as regards rights derived from collective agreements. It referred to a

Suggestion which has been strongly pressed in various quarters [...] that States should admit an exception to the most-favoured-nation clause whereby advantages derived from plurilateral agreements should be limited to the contracting States and to such States as may voluntarily grant equivalent advantages [...].

It has been argued [...] that, in the absence of an exception of this kind, the conclusion of collective conventions would encounter insuperable difficulties, since the application of the clause would, in such circumstances, place a premium on abstention. On the other hand, it has to be borne in mind that the circumstances of various countries differ considerably, so that in many cases they could not adhere to a plurilateral agreement when they are unaware of the concrete cases to which its provisions might later be applied

and of the possible consequences which its application might involve for themselves. Moreover, there would be a danger of provoking the formation of mutually opposed groups of countries, thus aggravating the very evils which it is sought to mitigate. Finally, it has been emphasised that care must be taken to avoid prejudicing the rights of third parties.

In any case, these exceptions must be subject to the condition that agreements of this kind be open to the adhesion of all interested States and that their aim should be in harmony with the general interest. Amongst the conditions that might be considered for this purpose, mention may be made of a proviso that these agreements shall have been concluded under the auspices of the League of Nations or of organizations dependent on the League. Further, these agreements must not involve new hindrances to international trade vis-à-vis countries having most-favoured-nation rights. Finally "collective agreements" can only be regarded as such when they comply with certain conditions, to be determined, as to the number of participating States.<sup>106</sup>

The Commission of the Experts, who were plainly not of one mind on this issue, concluded this part of the report with the hopeful if vague recommendation that "the Conference should endeavour to find a solution for the whole of this question which will reconcile the interests of all".

101. Under the heading "Temporary exceptions" the report recommended consideration whether too rigid an insistence on most-favoured-nation rights might not involve a risk, in certain cases, of creating difficulties in the path of economic progress which might be overcome by admitting temporary exceptions. In this respect, however, the utmost prudence was felt necessary. Attention was drawn to the so-called agrarian preferences which the Danube countries have received through special agreements in respect of limited quantities of cereals on the basis of the recommendations of the Stresa Conference for the economic restoration of Central and Eastern Europe (September 1932).<sup>107</sup>

102. The Monetary and Economic Conference took place in London in the Geological Museum at South Kensington. Sixty-four States were represented.<sup>108</sup> Much of the general debate in the Conference centred on the problems of international trade. The vital need for a lowering of tariff barriers was generally recognized, without agreement on the means of achieving that aim. The role of the most-favoured-nation clause was emphasized by many speakers.<sup>109</sup>

103. The delegation of the USSR, headed by Litvinov, introduced a proposal to conclude a pact of economic non-aggression. According to the relevant draft resolution the signatory Governments would withdraw reciprocally all the legislative and administrative measures already passed by them having the nature of economic aggression or discrimination against any one country. The types of

<sup>106</sup> *Ibid.*, pp. 31-32.

<sup>107</sup> *Ibid.*, p. 32. For the Stresa Conference, see Royal Institute of International Affairs, *Survey of International Affairs, 1932* (London, Oxford University Press, 1933), pp. 19-27.

<sup>108</sup> According to A. J. Toynbee, the historian, it was perhaps both the best attended and least effective international gathering that had ever been held up to its date. Royal Institute of International Affairs, *Survey of International Affairs, 1933* (London, Oxford University Press, 1934), p. vi.

<sup>109</sup> *Ibid.*, pp. 49-56 for the details.

<sup>108</sup> League of Nations, document C.48.M.18.1933.II.

<sup>104</sup> This qualification may raise a grim smile when reread thirty-five years later.

<sup>105</sup> League of Nations, document C.48.M.18.1933.II, p. 31.

economic warfare denounced by the Soviet delegation included all methods of discrimination, tariff wars, covert or overt, currency wars, the discriminatory prohibition of imports and exports, and all forms of official boycott.<sup>110</sup> The proposal failed to receive enough support. In almost all other matters the Conference was equally unsuccessful. Its practical results were negligible.<sup>111</sup> Its Sub-Commission on Commercial Policy devoted a section in its report to the most-favoured-nation clause which ran partly as follows:

*The Most-Favoured-Nation Clause*

This problem has also been studied by the Sub-Commission especially from the point of view of the exceptions that might be allowed in order to make its application more elastic and better suited to present conditions.

There was a general opinion in favour of the maintenance of the most-favoured-nation clause, in its unconditional and unrestricted form—naturally with the usually recognised exceptions—stressing the points that it represents the basis of all liberal commercial policy; and that any general and substantial reduction of tariffs by the method of bilateral treaties is only possible if the clause is unrestricted; and that this method would avoid the constant resumption of negotiations.

However, certain delegations manifested a strong tendency in favour of allowing new exceptions in addition to those hitherto unanimously admitted, on the ground that, although the unconditional and unrestricted most-favoured-nation clause does, under normal conditions, secure for trade the indispensable minimum of guarantees and prevents arbitrary and discriminatory treatment, if insisted upon with too great rigidity, it may obstruct its own purposes in a period of crisis and difficulty such as we are now passing through.

As regards the nature of these exceptions, opinion differed very widely, and the following recommendations were made:

An exception in favour of collective conventions for the reduction of economic barriers, open to all countries;

An exception in favour of agricultural products;

An exception in favour of agreements arising out of historic ties between certain countries, subject to a favourable opinion by the Council of the League of Nations;

An exception in favour of agreements binding only those countries which undertake to accept a certain regime and to maintain a certain standard of living for their population;

An exception in favour of the agreements contemplated at Stresa and in favour of regional and collective agreements concluded under the auspices of the League of Nations;

An exception based on reciprocity and equitable treatment.<sup>112</sup>

*7. The Seventh International Conference of American States (1933)*

104. In 1933, the year of the World Monetary and Economic Conference, the Seventh International Conference of American States was also held. Opened in Montevideo on 3 December, after the conclusion of the London Conference, it also took a stand on economic matters and dealt with the role of the most-favoured-

nation clause. Its principal achievement on the economic plane was the adoption of a resolution on economic, commercial and tariff policy on 16 December 1933. On the problem of the most-favoured-nation clause the resolution contained the following passage:

The subscribing Governments declare that the principle of equality of treatment stands and must continue to stand as the basis of all acceptable commercial policy. Accordingly, they undertake that whatever agreements they enter into shall include the most-favoured-nation clause in its unconditional and unrestricted form, to be applied to all types of control of international trade, limited only by such exceptions as may be commonly recognized as legitimate, and they undertake that such agreements shall not introduce features which, while possibly providing an immediate advantage for the Contracting Parties, might react disadvantageously upon world trade as a whole.

The subscribing Governments declare further that the most-favoured-nation principle enjoins upon States, making use of the quota system or other systems for limiting imports, the application of these systems in such a way as to dislocate as little as possible the relative competitive positions naturally enjoyed by the various countries in supplying the articles affected.

With a view to encouraging the development of unified and comprehensive multilateral treaties as a vitally important instrument of trade liberalization, the advantages of which treaties ought not to be open to countries which refuse to confer similar advantages, the subscribing Governments declare, and call upon all countries to declare, that they will not invoke their right to demand, under the most-favoured-nation clause contained in bilateral treaties to which they may be parties, any benefits of multilateral treaties which have as their general purpose the liberalization of international economic relations and which are open to the accession of all countries, provided that such renunciation shall not operate in so far as the country entitled to most-favoured-nation treatment in fact reciprocally accords the benefits which it seeks.

For the purpose of carrying out the policy embraced in the foregoing undertaking, the subscribing Governments favour the establishment of a permanent international agency, which shall closely observe the steps taken by each of them in effecting reductions of trade barriers, and which shall upon request furnish information to them regarding the progress made by each in effectuating the aforesaid programme.<sup>113</sup>

105. In the course of the Montevideo Conference of 1933, the United States delegation had put forward also a proposal in connexion with "the development of economic relations among the peoples of the world by means of multilateral conventions, the benefits of which ought not to accrue to countries which refuse to assume their obligations". The suggestion was that the Governments of the American republics should bind themselves by a general convention not to

invoke the obligations of the most-favoured-nation clause for the purpose of obtaining advantages enjoyed by the parties to multilateral economic conventions of general applicability, which include a trade area of substantial size, have as their objective the liberalization and promotion of international trade or other international economic intercourse, and are open to adoption by all countries.<sup>114</sup>

This proposal was discussed, but it did not meet with general acceptance, and the Conference decided in its "Resolution on Multilateral Commercial Treaties"

<sup>110</sup> Monetary and Economic Conference, document Conf. M.E./C.E.15; Royal Institute of International Affairs, *op. cit.*, p. 52.

<sup>111</sup> Royal Institute of International Affairs, *op. cit.*, p. 76.

<sup>112</sup> League of Nations, document C.435.M.220.1933.II [Conf. ME 22 (1)], pp. 22-23.

<sup>113</sup> Seventh International Conference of American States (Montevideo, Uruguay, December 3-26, 1933), *Final Act*, pp. 23-24.

<sup>114</sup> *Ibid.*, p. 124.

(24 December 1933) that the American draft convention should be deposited at the office of the Pan American Union and declared open to adherence by all countries.<sup>115</sup> The resolution of the Conference was embodied in an "Agreement on the application of the most-favoured-nation clause", opened to signature on 15 July 1934.<sup>116</sup>

<sup>115</sup> *Ibid.*

<sup>116</sup> Pan American Union, Serie sobre tratados No. 6, OEA Documentos oficiales OEA/Ser. A/51a (SEPF).

It has been signed by six States but ratified only by two: Cuba and the United States in 1935.

#### 8. Codification by the Institute of International Law

106. The Institute of International Law examined the "effects of the most-favoured-nation clause in matters of commerce and navigation" in the course of its 1934 and 1936 sessions and adopted a resolution on the topic at its session held at Brussels in 1936. The text of this resolution is contained in annex II.

## ANNEXES

### ANNEX I

#### Excerpts from the conclusions of the Economic Committee of the League of Nations in regard to the most-favoured-nation clause<sup>1</sup>

##### *Can States claim most-favoured-nation treatment from each other as a right?*

"In fact, different conceptions regarding tariffs and contractual methods appear to be generally associated with different ideas regarding most-favoured-nation treatment. While the States which refuse to negotiate in tariff matters claim most-favoured-nation treatment as a preliminary condition of any treaty and as a right which is beyond discussion, on the other hand, those States which have conceived their tariffs with a view to negotiation and who attach more value to tariff agreements than to the juridical guarantee constituted by the most-favoured-nation clause, when it is not accompanied by tariff advantages, consider the grant of the most-favoured-nation clause as subordinate to agreement on tariffs.

"The Committee was of opinion that the Economic Conference of 1927 had not embraced the doctrine which considers equality of treatment as a right above question. It has borne in mind that the resolutions of the Conference declare that each State must judge in what cases and to what extent this fundamental guarantee should be embodied in any particular Treaty. But it has taken care, on the other hand, not to misunderstand that the doctrine clearly affirmed by the Conference was in favour of the reciprocal grant of most-favoured-nation treatment and in favour of the widest possible extension of its scope and of a liberalism as enlightened as possible in its application.

"In this matter... the Committee has inclined towards a compromise of fact rather than to a choice between opposing doctrines. It is convinced that, whereas those States which claim most-favoured-nation treatment by right before any negotiation nevertheless reserve the power to revise it if they run against prohibition duties or unjust discrimination, the States which regard most-favoured-nation treatment as the price of a favourable tariff agreement nevertheless admit, in general theory, that this agreement could not be arrived at without the grant of most-favoured-nation treatment.

<sup>1</sup> Excerpts from: (i) "Recommendations of the Economic Committee relating to Tariff Policy and the Most-Favoured-Nation Clause" (document E 805.1933.II.B.1.(a) [hereinafter "1933 document"]), and (ii) Economic Committee, "Equality of Treatment in the Present State of International Commercial Relations: The Most-Favoured-Nation Clause" (document C.379.M.250.1936.II.B. [hereinafter "1936 document"]).

(a) See foot-note 90 above.

"The Committee has noted, therefore, that unanimity could undoubtedly be reached on a doctrine which declared that the grant of most-favoured-nation treatment ought to be the normal, and that the refusal of this guarantee or the corresponding establishment of a differential regime ought not to arise unless in the case of States which refuse an equitable tariff policy or have recourse to discriminatory practices."<sup>2</sup>

##### *The most-favoured-nation clause in customs matters: a plea for the clause to be unconditional...*

"The most-favoured-nation clause implies the right to demand and the obligation to concede all reductions of duties and taxes and all privileges of every kind accorded to the most favoured nation, no matter whether such reductions and privileges are granted autonomously or in virtue of conventions with third parties.

"Regarded in this way, the clause confers a whole body of advantages, the extent of which actually depends on the extent of the concessions granted to other countries... At the same time, it constitutes a guarantee, in the sense that it provides completely and, so to speak automatically, for full and entire equality of treatment with the country which is most favoured in the matter in question.

"However, in order that the clause may produce these results, it must be understood to mean that a Government which has granted most-favoured-nation treatment is bound to concede to the other contracting party every advantage which has been granted to any third country, immediately and as a matter of right, without the other party being required to give anything by way of compensation. In other words, the clause must be unconditional.

"As is generally known, conditional most-favoured-nation clauses have in some cases been inserted in treaties, while in other cases existing most-favoured-nation clauses have been construed in a conditional sense, with the effect that a reduction of duties granted to a given country in exchange for a given concession may not be accorded to a third country, except in exchange for the like or equivalent concessions. This opinion is based on the conception that a country which has not, in some given respect, made the same concessions as another is not entitled to obtain, in this respect, the same advantages, even if it has made wider concessions in other respects. It cannot, however, be too often repeated that a conditional clause of this kind—in justification of which it is argued that, if it does not grant equality of tariffs, it offers at any rate equality of opportunity—has nothing whatever in common with the sort of clause

<sup>2</sup> 1933 document, p. 68.

which the [1927] International Economic Conference and the Economic Consultative Committee recommended for the widest possible adoption.

"It is in fact the negation of such a clause, for the very essence of the most-favoured-nation clause lies in its exclusion of every sort of discrimination, whereas the conditional clause constitutes, by its very nature, a method of discrimination; it does not offer any of the advantages of the most-favoured-nation clause proper, which seeks to eliminate economic conflicts, to simplify international trade and to establish it on firmer foundations. Moreover, it is open to the very grave objection of being unfair to countries which have very few, or very low, duties, and which are thus less favourably situated for negotiating than those which possess heavy or numerous duties.<sup>3</sup>

"...

"Moreover, it has very rightly been observed<sup>a</sup> that the granting of the conditional clause really amounts to a polite refusal to grant the most-favoured-nation clause, and that the real significance of this "conditional clause" is that it constitutes a *pactum de contrahendo*, by which the contracting States undertake to enter later into negotiations to grant each other certain advantages similar or correlative to those previously granted to third countries.<sup>4</sup>

<sup>a</sup> Viner—*The Most-favoured-nation Clause, Index*, January 1931.

"...

"We may therefore conclude that the first fundamental principle, implicit in the conception of most-favoured-nation treatment, is that this treatment must be *unconditional*".

*... and unrestricted*

"... in order to allow for the free play of competition in international trade and to present the reintroduction of discrimination, the clause needs to be not only unconditional, but also unrestricted; in other words, it must apply to the whole of the tariffs of the contracting countries.

"If the clause is made not to apply to a large number of articles or even to a single article which plays an important part in the trade between two countries, it ceases to provide equality of treatment with any third State and, on the contrary, results in actual discrimination as between the country which is thus excluded from certain advantages in respect of particular goods and the country or countries which receive such advantages.

"Such discrimination may, in a certain sense, be regarded as legitimate, if it has been agreed to by the country which it affects. But [...] such a restriction could only be accepted with reluctance, and consequently an agreement based on the restricted clause could merely be regarded by the contracting party who is the chief sufferer by the restrictions as a lesser evil than the absence of any agreement whatsoever in regulation of trade.

"[...]

"[Even if these] restrictions affect both parties to the same extent [...], the agreement based on the granting of limited, though ostensibly equivalent, advantages only constitutes a very imperfect application of the most-favoured-nation treatment.

"..."

*Fields other than Customs matters*

"If the clause fulfils these two fundamental conditions—in other words, if it is unconditional and unrestricted—it assures the best treatment which two countries can possibly grant one another in Customs questions.

"In other fields, the most-favoured-nation clause, even if unconditional and unrestricted, only represents on the contrary a minimum of the privileges and safeguards which two countries can grant one another; we would instance, as examples, the treatment of nationals permitted to engage in business in a foreign country (the right of establishment), the payment of direct and indirect taxes on the exercise of any commercial activity, the payment of internal taxes on the manufacture, distribution and consumption of goods, and also on navigation (not including coastal traffic).

"Without going further into these questions, we may observe that it is generally admitted—either in theory or in international practice—that, in regard to the points we have just mentioned, national treatment is as a rule an indispensable condition for the free and productive growth of co-operation between peoples; in consequence, the most-favoured-nation clause can in such cases only offer an additional safeguard supplementing those already provided by national treatment."

*Fields not appropriate for the clause*

"... it must be admitted that, in regard to certain questions, the treatment provided by the clause is too wide in its scope and that these questions can only be properly regulated on a reciprocal basis. This applies, for example, to double taxation.

"..."

*What is to be understood by the term "Customs questions"?*

"According to the general practice in commercial treaties, the term 'Customs questions' includes the scales of Customs duties and the method of levying them—i.e., import and export duties, supercharge co-efficients, where they exist, and subsidiary charges of every sort levied on imports or exports. The term also covers all the rules, formalities and charges inseparable from Customs operations of every description (including, for instance, the regulations for the treatment of passengers' luggage or commercial travellers' samples; the procedure and time limits for appeals to administrative, judicial or arbitral authorities against Customs decisions relating to the application of tariffs).

"..."

*The operation of the clause in the presence of import and export prohibitions*

"... the principle universally recognised prior to the war was that of freedom of trade; in other words, prohibitions on economic grounds were non-existent. There was therefore no occasion to demand the most-favoured-nation clause in questions of this sort.

"The war made it necessary to close the markets wholly or in part to a number of articles, indeed in some cases to goods of all kinds. The abnormal economic situation in the period immediately after the peace induced many Governments to make considerable use of prohibitions.

"..."

"As the situation gradually became more normal again, the principle of most-favoured-nation treatment gained ground and was expressly stipulated in a number of treaties, some of which also provided that such concessions should be limited to quotas.

"One question continued to be a subject of keen debate: whether, in cases where the most-favoured-nation clause was not expressly extended to the import and export system, regarded in the above sense, prohibitions should nevertheless be deemed to come under the clause, as falling within the general boundaries of Customs questions; or whether, on the contrary, they should be governed by the principle of reciprocity?

"..."

"... we should, in principle, conclude that the standard most-favoured-nation clause herein suggested does not, unless other-

<sup>3</sup> 1933 document, pp. 69-70.

<sup>4</sup> 1936 document, p. 24.

wise expressly stipulated in commercial treaties, apply to prohibitions. But we must not forget that this solution does not entirely meet the present situation. Although prohibitions have in the main been abolished, some still exist and, as long as this continues to be the case, it would be desirable that the interpretation adopted during and after the war, to the effect that the clause should apply as far as possible to prohibitions, should still be adhered to.<sup>5</sup>

“...”

*Customs quotas: are they compatible with the unconditional and unrestricted most-favoured-nation clause?*

[The following considerations pertaining to Customs quotas, i.e. quotas limiting the agreed Customs concessions to definite quantities, apply *mutatis mutandis* also to import quotas, i.e. quotas limiting the import of certain goods altogether.]

“In the first place, it should be pointed out that the most-favoured-nation clause has two objects: (a) to secure to the country enjoying its benefits a total of advantages represented by all the Customs concessions and privileges granted to third countries and by all the concessions made by autonomous act, and (b) to ensure absolute equality of treatment by guaranteeing to all countries which enjoy its benefits equal terms in all matters covered by commercial treaties and, as a result, the free development of their economic aspects.

“The total advantages assured by the clause are not fixed or immutable. They may be increased if the State that grants the most-favoured-nation treatment concludes new commercial treaties making new or greater concessions in favour of other States or grants fresh privileges or advantages by autonomous act. They may decrease if one of the former commercial agreements becomes null and void, or if one of the privileges granted by autonomous act is withdrawn. For that reason, a State which in virtue of the clause has had the right to import an unlimited amount of certain goods at a given Customs duty cannot claim that the clause has been violated merely because the duty in question has been raised later by means of an autonomous provision and it only continues to benefit from the former duty for quantities corresponding to a Customs quota.

“But, if a State is not entitled to preserve unchanged the original advantages of the clause, it certainly has the right of insisting that the principle of equality of treatment which is assured by the clause, and which consists in guaranteeing every country equal conditions where international commercial competition is concerned, should not be departed from.<sup>6</sup>

“Up to the present, no system has been discovered by which quotas can be allocated without injuring the interests of countries entitled to benefit under the most-favoured-nation clause. The three principal methods tried up to the present are:

“1. The so-called ‘arithmetical’ method, by which all countries may import the same quantities of a given commodity. *Summum jus, summa injuria*.<sup>7</sup>

“[T]he object of the clause is to preserve respective positions [of the interested States] intact, by treating all countries *on the same footing*, which is quite a different thing from treating all countries in a mechanically equal way.<sup>8</sup>

“2. What is known as the ‘proportional’ method has been held to be more in keeping with the spirit of the clause. Under this method, each country is allowed to import, in the case of any given product, a quantity representing a definite proportion of the total quantity imported during a basic reference period. For very many reasons, however, the choice of a suitable basic period is a very difficult matter and gives rise to disputes of

many kinds. Moreover, in view of the rapidity with which, at the present time, changes take place in production and sale conditions in the various countries, it is impossible to discover, among the statistics of the past, a basis which satisfies *equally* the *present* needs of all countries. This method, though it has no direct connexion with the clause, for a fundamental reason that we shall explain later, is nevertheless the only one which can ensure as equitable an allocation as the existence of quotas allows.

“...”

“3. The third method is to fix a total quota of permitted imports without allocating it among the various countries, and leaving all comers to compete for it. This method might be regarded as that which is least contrary to the principle of the clause, but, for practical and administrative reasons, it has seldom, if ever, been applied in this crude form.”<sup>9</sup>

“... it is inevitable that quotas should disturb the freedom of competition between the various countries interested, so that they develop into a violation of the most-favoured-nation clause.

“As a general rule, therefore, they are to be condemned and avoided.

“If, however, their tendency is to *regulate* the import trade by helping to tide over periods of temporary difficulty, in such cases they must be so fixed as to cause a minimum of injury to the interests of third countries.

“Any country desiring to adopt Customs quotas must bear in mind that the most-favoured-nation treatment which it has conceded to other countries imposes on it the obligation not to impair the equality of conditions in international commercial competition; therefore, quotas must be fixed so as to safeguard, as far as possible, the position of the countries interested. Whether this is done by fixing the first Customs quota with the principal exporting country, or by negotiations conducted with each of the various interested countries in turn, is not a matter of essential importance.

“What is of importance is that the interests of the various countries enjoying most-favoured-nation treatment should be considered and respected.

“...”

*Will the clause operate in the case of temporary imports and exports?*

“... a distinction must be drawn between temporary imports and exports in the true sense of the term and the so-called finishing trade.

“In regard to the former, the clause applies to all concessions which, being solely designed to facilitate international trade, relate only to goods which are not intended to undergo any further transformation (for instance, containers, imported empty and re-exported full, implements and apparatus intended for the erection of plant and re-exported on completion of the work; goods sent to fairs or exhibitions and re-exported because they have not been sold).

“On the other hand, the special cases of temporary imports and exports which come under the description of finishing trade give rise to the following considerations:

“...”

“The term ‘*active*’ finishing trade is employed when a Government authorises the importation free of duty, or at a reduced rate, of foreign goods (usually raw materials or semi-finished articles) on condition that such goods are transformed into finished articles of a specified character intended solely for export.

“...”

<sup>5</sup> 1933 document, pp. 70-74.

<sup>6</sup> *Ibid.*, p. 80.

<sup>7</sup> 1936 document, p. 14.

<sup>8</sup> 1933 document, p. 81.

<sup>9</sup> 1936 document, p. 14.

*The Economic Committee had no difficulty in reaching the conclusion that:*

"... it would be in flagrant contradiction with the principle of equality of treatment, implicit in the most-favoured-nation clause, if a country to which this treatment had been granted in Customs questions were to be debarred from the privilege of exemption.

"The most-favoured-nation clause must therefore be applicable to 'active' finishing trade, it being understood, however, that, when the laws of a country make this trade dependent on an administrative decision, the right of the competent authorities to take a decision in each particular case is in no way affected thereby.

"The Economic Committee arrived at a somewhat different conclusion in regard to 'passive' finishing trade.

"'Passive' finishing trade arises when a country authorises the temporary export of certain goods, and readmits them free of duty when they return to the country after being finished abroad.

"..."

*The Committee found that:*

"... among the countries which follow an autonomous policy in regard to temporary exports, a certain number apply the most-favoured-nation clause to the 'passive' finishing trade....

"Other countries, on the contrary, deny that 'passive' finishing trade can be governed by the most-favoured-nation clause, arguing that a concession which could be defended in regard to one country might have no justification in regard to another.

"Having regard to the diversity of opinions and systems, the Economic Committee did not feel able to advocate the application of most-favoured-nation treatment to 'passive' finishing trade. It did, however, express the opinion that a country would only be justified in refusing, under the most-favoured-nation clause, to extend to others the concessions already granted to one country, if the other country demanding them were quite differently situated—in regard to the circumstances in view of which the concessions were allowed—from the country to which they had originally been granted."<sup>10</sup>

In concurrence with the views of the Economic Committee, the Institute of International Law, in paragraph 5 of its resolution of 1936, excepted only "passive" finishing trade (See annex II below).

[Nolde finds it difficult to follow the reasoning of the Economic Committee and believes that the clause should apply equally to "active" and "passive" finishing trade.<sup>11</sup>

#### *Essential characteristics of goods benefiting by the clause*

"The two essential conditions are as follows:

"The goods must *have their origin* in the country which enjoys most-favoured-nation treatment, and they must be *like products*, in the sense that they must possess the characteristics which entitle certain goods to a given Customs treatment."<sup>12</sup>

"..."

#### *Nationality of a product*

"The basis taken for the purpose of determining the nationality of a product shall be its origin. The origin declared at the Customs shall be accepted, provided that such evidence of origin or

consignments as the legislation of the importing country may require is produced, and provided that there is no presumption of the incorrectness of the declaration of origin.

"The country of origin in the case of *natural* products shall be taken to be the country in which such products have been grown, harvested, extracted or in any other manner obtained, or, in other words, the products of the soil or sub-soil of the country in question.

"The country of origin of *manufactured* products shall be taken to be the country in which such products have been finished. No account shall be taken of the origin of the raw materials or of the raw, semi-manufactured or manufactured products which have entered into the composition of a product, or of the fact that the work of manufacturing or finishing took place in free circulation or under Customs supervision, except, however, in the case in which finishing is only aimed at evading payment of a higher duty.

"..."

"We may... lay down the principle that the following operations undergone by a consignment on its journey will be considered not to affect its origin—viz., unloading and reloading, changes in the mode of transport, bonding in Customs warehouses, free ports or free zones, external alterations in the putting up of the goods, division into lots or sorting, provided always that the origin appears clearly from the accompanying papers and that the above operations have taken place under official supervision and are attested in a satisfactory manner (by the Customs authority or the management of the bonded warehouses or free ports, etc.)."

"..."

#### *"Like products"*

"Coming next to the question of what conditions, as regards their nature, the goods must fulfil in order to qualify for most-favoured-nation treatment, it may be observed that these conditions are usually expressed by the words 'like' or 'similar' and sometimes by 'identical'. If these expressions are held to imply different standards, it must be admitted that the word 'like' is far preferable to the others, the expression 'identical' being the least desirable of the three, since the condition of identity may in practice involve a too restricted application of the clause, and is moreover too difficult to determine. However, the problem will not be solved merely by the use of one or other of these expressions. If we adopt the word 'like' we have still to decide what in practice is meant by 'like products'.

"..."

"... we may hope that the difficulties inherent in this question will be diminished with the introduction of the uniform Customs nomenclature....

"But what we are most concerned to declare is that, no matter what standards may be used to determine, in the case of a given category of goods, that these goods are 'like products', these standards must be applied in the same manner to all products of that category having their origin in any of the countries entitled to the benefit of the clause.<sup>13</sup>

"..."

#### *Exceptions to the clause*

##### *Frontier traffic*

"The strict maintenance of a Customs barrier between two adjacent countries is so clearly hampering to the inhabitants of the frontier districts, in regions where the frontier is not represented by some almost impassable physical obstacle, and an agreement allowing freedom of trade within a restricted zone

<sup>10</sup> 1933 document, pp. 85-88.

<sup>11</sup> B. Nolde, "La clause de la nation la plus favorisée et les tarifs préférentiels", *Recueil des cours de l'Académie de droit international de La Haye*, 1932, t. 39, p. 43.

<sup>12</sup> 1933 document, p. 89.

<sup>13</sup> *Ibid.*, pp. 91-93.

on each side of the frontier is so manifestly justifiable that an exception in favour of such traffic is something to which a third party, entitled in other respects to most-favoured-nation treatment, could not reasonably object. Accordingly, in most commercial treaties, allowance is made for the special situation in these districts by excepting the Customs facilities granted to frontier traffic from the most-favoured-nation regime.

“... ”

“... the reservation, where employed, is of a more or less elastic character.

“In any case, it must be admitted that the exception concerning frontier traffic is rendered necessary, not merely by long-standing tradition, but by the very nature of things, and that it would be impossible, owing to differences in the circumstances, to lay down precisely the width of frontier zone which should enjoy a special regime. Hence we must be content to state that this exception is only legitimate and admissible if it is restricted to such limits as are essential to the attainment of its purpose—i.e., to facilitating trade and in some cases also to rendering existence practicable for the inhabitants on either side of the frontier.”

#### *Customs unions*

“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.”

“... ”

#### *Special exceptions*

“Apart from Customs unions, it is necessary to consider the case of concessions which some countries grant one another on account of the special ethnic, historical, geographical or other ties which unite them (e.g., the Iberian Clause, the Baltic Clause, the Scandinavian Clause, the South-American Clause, etc., and the special regime between Switzerland and certain zones of French territory).

“The exceptions falling within these categories could not be accepted as *implicit* by a mere reference; they must be expressly stated and their meaning and scope must be agreed to by the parties concerned.”

#### *Wording of the clause*

“A study of the numerous examples which might be quoted would show that the most-favoured-nation clause takes the most varied forms in different treaties.

“... ”

“These differences... cannot fail in the long run to work to the prejudice of international trade, which—more particularly in this field—needs rules which are clear, unequivocal, simple and intelligible to all.

“The elaboration of a single form of clause for Customs matters appears in these circumstances to be a work of the greatest utility.

“The question then arises whether it will be best to be content with an extremely simple and purely synthetic form of words

merely declaring the intention of the contracting parties to grant each other most-favoured-nation treatment (leaving the actual scope of this guarantee to be elucidated in accordance with the rules for interpretation), or to adopt a rather more explicit style, stating the substantial provisions of the clause in direct terms in accordance with the principles we wish to see universally accepted.

“The former method, that of an extremely simple clause (such, for instance, as the following: ‘The two Contracting Parties undertake to grant each other most-favoured-nation treatment in all Customs questions’) would perhaps make it easier for everyone to adopt the clause. But it would have the objection of leaving open all questions connected with the scope of the most-favoured-nation clause and of making the positive value of the clause *wholly* and *exclusively* dependent on the rules for interpretation.

“For these reasons, we have thought it better to adopt the second method... ”

“The outcome of these considerations is the following formula, the terms of which are appreciably more explicit than those given above as an example. This formula is worded in general terms which may be adapted to meet special circumstances:

“ ‘The High Contracting Parties agree to grant each other unconditional and unrestricted most-favoured-nation treatment in all matters concerning Customs duties and subsidiary duties of every kind and in the method of levying duties, and further, in all matters concerning the rules, formalities and charges imposed in connexion with the clearing of goods through the Customs.

“ ‘Accordingly, natural or manufactured products having their origin in either of the contracting countries shall in no case be subject, in regard to the matters referred to above, to any duties, taxes or charges other or higher, or to any rules and formalities other or more burdensome, than those to which the like products having their origin in any third country are or may hereafter be subject.

“ ‘Similarly, natural or manufactured products exported from the territories of either Contracting Party and consigned to the territories of the other Party shall in no case be subject, in regard to the above-mentioned matters, to any duties, taxes or charges other or higher, or to any rules and formalities other or more burdensome, than those to which the like products when consigned to the territories of any other country are or may hereafter be subject.

“ ‘All the advantages, favours, privileges and immunities which have been or may hereafter be granted by either Contracting Party, in regard to the above-mentioned matters, to natural or manufactured products originating in any other country or consigned to the territories of any other country shall be accorded immediately and without compensation to the like products originating from the other Contracting Party or to products consigned to the territories of that Party.

“ ‘Nevertheless, the advantages now accorded or which may 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.’ ”<sup>14</sup>

#### *Relations between bilateral agreements based on the most-favoured-nation clause and economic plurilateral conventions*

“During the Diplomatic Conference held at Geneva to draw up an International Convention on the Abolition of Import and Export Prohibitions and Restrictions, the question arose whether States not parties to that Convention could, by virtue of bilateral agreements based on the most-favoured-nation clause, claim the

<sup>14</sup> *Ibid.*, pp. 97-101.

benefit of any advantages mutually conceded by the signatories of the International Convention. In deference to this consideration, it was even proposed to include a clause to that effect in the Convention. It was soon realized, however, that this question could not be answered in the Convention, which could not affect the contents of bilateral agreements based on the most-favoured-nation clause. The Conference realised the great importance of the problem, both for the general economic work of the League and for the conclusion of future economic agreements under the League's auspices, and the nature and field of application of such agreements. It was urged at the Conference that the conclusion of plurilateral conventions would be hindered if countries, while not acceding to such agreements, could still, without giving any counter-engagements, avail themselves of the engagements undertaken by the signatory States of such conventions.

"The Economic Committee of the League was asked to make an exhaustive study of the most-favoured-nation clause in commercial treaties and to put forward proposals regulating it in as comprehensive and as uniform a manner as possible, and it has carefully considered the question, which is the subject of the present report. It took the view that the World Economic Conference of Geneva, when it recommended the conclusion of plurilateral economic conventions with the object of improving the world economic situation and the application of the most-favoured-nation clause in the widest and most unconditional form, probably did not quite realise that—up to a point—these two recommendations might clash. One argument—and a very sound one—brought up in the Economic Committee was that in certain cases countries would have little or no interest in acceding to a plurilateral economic convention or in undertaking the commitments it entailed if, by invoking the most-favoured-nation clause, as embodied in bilateral agreements, they could claim as of right and without incurring corresponding obligations, that the obligations contracted by the signatory States of the plurilateral convention should apply to themselves. It was strongly urged, indeed, that such possibility might seriously impair the whole future economic work of the League and that the only means of averting the danger would be to adopt a provision whereby the most-favoured-nation clause embodied in bilateral commercial treaties would not, as a rule, affect plurilateral economic conventions.

"It was objected, however, that a clause of this kind, instead of leading, as the World Economic Conference recommended, to the unlimited application of the most-favoured-nation clause, would actually check it, and that, more especially in countries where the unlimited application of this clause is the basis of commercial relations with foreign countries, such a reservation would probably be misunderstood and might give rise to a hostile attitude towards the League's economic work. It was further argued that a State might quite conceivably, on wholly serious and genuine grounds, be unable to undertake the commitments involved by an international economic convention; that the final decision whether it could do so or not would lie with the State itself; and that it could hardly be asked, as a result of a most-favoured-nation clause drafted *ad hoc* in bilateral commercial treaties, to give up the right in cases of this kind to refuse to accept differential treatment on the part of one or more other States.

"The arguments advanced on both sides are so cogent that the Economic Committee has not found it possible at this moment to find a general and final solution for this difficult problem.

"It is unanimously of opinion, however, that, although this reservation in plurilateral conventions may appear in some cases legitimate, it can only be justified in the case of plurilateral conventions of a general character and aiming at the improvement of economic relations between peoples, and not in the case of conventions concluded by certain countries to attain particular ends the benefits of which those countries would, by such a procedure, be refusing to other States when the latter might,

by invoking most-favoured-nation treatment, derive legitimate advantages.

"The said reservation should also be expressly stipulated and should not deprive a State not a party to the plurilateral convention of advantages it enjoys either under the national laws of the participating State or under a bilateral agreement concluded by the latter with a third State itself not a party to the said plurilateral Convention.

"Finally, this reservation should not be admitted in cases in which the State claiming the advantages arising under the plurilateral convention, though not acceding to it, would be prepared to grant full reciprocity in the matter.

"The Economic Committee expresses the view that countries which, with reference to the terms of plurilateral economic conventions, agreed to embody in their bilateral agreements based on the most-favoured-nation clause a reservation defined in accordance with the principles set forth above would not be acting contrary to the recommendations of the World Economic Conference of Geneva, and consequently will not be acting in a manner inconsistent with the objects which the League has set itself to attain."<sup>15</sup>

Reservations of this kind were indeed embodied in several European treaties in the following years. One example is the following provisions of a commercial treaty concluded between the Economic Union of Belgium and Luxembourg and Switzerland on 26 August 1929:

"It is furthermore understood that the most-favoured-nation clause may not be invoked by the High Contracting Parties in order to obtain new rights or privileges which either of them may hereafter grant under collective conventions to which the other is not a party, provided that the said conventions are concluded under the auspices of the League of Nations or registered by it and open for the accession of the States. Nevertheless, the High Contracting Party concerned may claim the benefit of the rights or privileges in question if such rights or privileges are also stipulated in conventions other than collective conventions which fulfil the afore-mentioned conditions, or if the Party claiming such benefits is prepared to grant reciprocal treatment."<sup>16</sup>

(Cf. also the Pan-American Agreement of 15 July 1934. See para. 105 above).

## ANNEX II

### Resolution of the Institute of International Law, adopted at its fortieth session (Brussels, 1936)<sup>17</sup>

[Original text: French]

#### *The effects of the most-favoured-nation clause in matters of commerce and navigation*

Considering that the meaning and scope of the most-favoured-nation clause in matters of commerce and navigation often give rise to disputes and difficulties of interpretation;

Desiring to contribute to the legal construction and interpretation of this clause in the afore-mentioned matters;

Considering that to that end it is appropriate to formulate the rules of general law which are applicable unless there are provisions to the contrary;

<sup>15</sup> 1933 document, pp. 102-104.

<sup>16</sup> League of Nations, *Treaty Series*, vol. 105, p. 13.

<sup>17</sup> *Annuaire de l'Institut de droit international, session de Bruxelles (avril 1936)*, Paris, Pédone, édit., 1936, vol. II, pp. 289-292.

Reserving for subsequent study the questions relating to the application of the clause in other domains, particularly that of private international law:

The Institute of International Law adopts the following resolutions:

*Paragraph 1*

The most-favoured-nation clause is unconditional, unless there are express provisions to the contrary.

Consequently, in matters of commerce and navigation, the clause confers upon the nationals, goods and ships of the contracting countries, as a matter of right and without compensation, the regime enjoyed by any third country.

*Paragraph 2*

The most-favoured-nation clause confers upon the beneficiary the regime granted by the other contracting party to the nationals, goods and ships of any third country by virtue of its municipal law and its treaty law.

This regime of unconditional equality cannot be affected by the contrary provisions of municipal law or of conventions establishing relations with third States.

*Paragraph 3*

The duration of the effects of the most-favoured-nation clause is limited by that of the conventions with third States which led to the application of that clause.

*Paragraph 4*

By virtue of the most-favoured-nation clause, goods coming from or consigned to the contracting countries enjoy, as a matter of right and without compensation, treatment equal to that of goods coming from or consigned to third countries. The equal treatment applies to Customs duties and related duties, the method of levying them, and the rules, formalities and charges which may be applicable to Customs clearance operations.

*Paragraph 5*

The effects of the most-favoured-nation clause apply to the importation, exportation or transit of goods and to their temporary admission.

They do not apply to the "passive" finishing trade (i.e. the temporary export of goods for finishing abroad, and their subsequent reimportation duty-free after being finished).

*Paragraph 6*

For the purposes of paragraph 4 above, goods coming from contracting countries means goods imported from those countries, irrespective of their place of origin.

*Paragraph 7*

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

to the treatment which is or may hereafter be granted by either contracting country to an adjacent third State to facilitate the frontier traffic;

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

to the treatment resulting from the provisions of conventions open for signature by all States, whose purpose is to facilitate and stimulate international trade and economic relations by a systematic reduction of Customs duties;

to the treatment resulting from mutual and exclusive agreements between States, implying the organization of regional or continental economic regimes; or

to the regime resulting from an economic agreement among the members of a political community.

*Paragraph 8*

In the absence of a treaty provision to the contrary, the most-favoured-nation clause precludes the application of all so-called "anti-dumping" rights to the disadvantage of a country enjoying the benefits of most-favoured-nation treatment.

*Paragraph 9*

The most-favoured-nation regime must be applied in good faith and precludes recourse to all measures tending to create *de facto* discrimination against the contracting parties, contrary to the spirit of that regime.

*Paragraph 10*

All disputes concerning the interpretation and application of the most-favoured-nation clause should be resolved through the courts or by arbitration.

### ANNEX III

#### Selected bibliography on the most-favoured-nation clause

*Note:* The Codification Division of the Office of Legal Affairs of the United Nations Secretariat prepared for the convenience of the United Nations Conference on the Law of Treaties a "Selected Bibliography on the Law of Treaties", contained in document A/CONF.39/4 of 1 February 1968.

This bibliography contains in chapter I a list of treaties on international law and in chapter II, section I, a list of works relating to the law of treaties in general. It contains, however, no reference to works relating specifically to the most-favoured-nation clause, as has been pointed out in the explanatory note to the document.

The aim of the present bibliography, which is not intended to be exhaustive, is to complement the bibliography prepared by the Codification Division in respect of books and articles relating to the clause. To avoid duplication it contains no list of general works in regard to which the reader is referred to the above-mentioned document.

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