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MOST-FAVOURED-NATION CLAUSES

Note by the Secretariat

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## INTRODUCTION

1. In resolution 36/111 of 10 December 1981 the General Assembly has requested inter alia the United Nations Commission on International Trade Law to submit any written comments and observations which it deems appropriate on chapter II of the report of the International Law Commission (ILC) on the work of its thirtieth session, 1/ and in particular on the draft articles on most-favoured-nation clauses adopted by the International Law Commission and those provisions relating to such clauses on which the International Law Commission was unable to take a decision. The resolution is reproduced in the annex to this note.

### I. BACKGROUND TO GENERAL ASSEMBLY RESOLUTION 36/111

2. At its nineteenth session in 1967, the International Law Commission decided to place on its programme of work the topic of "most-favoured-nation clauses in the law of treaties". 2/ The title of the topic was shortened to "the most-favoured-nation clause" by the International Law Commission at its twentieth session in 1968.

3. The General Assembly, after considering the report of the International Law Commission on the work of its nineteenth session, recommended in resolution 2272 (XXII) of 1 December 1967 that the International Law Commission study the topic. From that time on, the topic was normally inscribed on the International Law Commission's agenda until its completion of the project in 1978.

4. At its thirtieth session in 1978, the International Law Commission finalized its draft articles on most-favoured-nation clauses and recommended to the General Assembly that the draft articles should be recommended to Member States with a view to the conclusion of a convention on the subject. 3/

5. After considering the report of the International Law Commission on the work of its thirtieth session, the General Assembly, by resolution 33/139 of 19 December 1978, invited all States, organs of the United Nations which had competence in the subject matter and interested intergovernmental organizations to submit their written comments and observations on the draft articles and on provisions on which the International Law Commission was unable to take a decision, and requested States to comment on the recommendation that the draft articles should be recommended to Member States with a view to the conclusion of a convention on the subject. Comments were received from 18 States and 5 intergovernmental organizations. 4/

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1/ Official Records of the General Assembly, Thirty-third Session, Supplement No. 10, A/33/10 and Corrigendum (Arabic only). (Yearbook of the International Law Commission 1978, Vol. II, Part Two.)

2/ Report of the International Law Commission on the work of its nineteenth session, 8 May-14 July 1967 (A/6709/REV.1 and REV.1/CORR.1), para. 48. (Yearbook of the International Law Commission 1967, Vol. II.)

3/ Report of the International Law Commission on the work of its thirtieth session, supra n. 1, para. 73.

4/ These comments are collected in A/35/203 and Add. 1-3, and compiled analytically in A/35/443.

6. On 15 December 1980, the General Assembly, aware of the fact that more replies were needed, adopted resolution 35/161, reiterating the invitation contained in resolution 33/139. Comments were received from 5 States, 1 organ of the United Nations and 5 intergovernmental organizations. <sup>5/</sup> At its thirty-sixth session the General Assembly adopted resolution 36/111.

## II. PURPOSE OF ILC DRAFT ARTICLES ON MOST-FAVOURED-NATION CLAUSES

7. The ILC draft articles are not intended to interfere with or prejudice the agreement of States upon most-favoured-nation treatment; rather, they have a residual character. They are designed to assist in the interpretation and application of most-favoured-nation clauses to which States might wish to agree in their international relations.

"The International Law Commission was unanimous in the view that the granting and beneficiary States might agree on most-favoured-nation treatment in all matters that lent themselves to such treatment: they might specify the sphere of relations in which they undertook most-favoured-nation obligations and they might restrict ratione materiae their respective promises. The Commission also agreed that States might, in the clause itself or in the treaty containing the clause or otherwise, reserve their right to grant preferences, i.e. to except from the application of the most-favoured-nation clause favours that they granted to one or more States. It is understood, however, in this connexion, that the present article should not be used as a pretext for discrimination." <sup>6/</sup>

Pursuant to draft article 29, the draft articles would be without prejudice to any provision on which the parties to a most-favoured-nation clause may otherwise agree.

8. The draft articles, therefore, do not purport to prescribe the existence, nature or scope of most-favoured-nation treatment in relations among States. For example, the draft articles would not obligate States to grant most-favoured-nation treatment to any other State. Nor would they require the granting of any particular type of most-favoured-nation treatment (e.g. unconditional, conditional or reciprocal). Such matters would depend upon the agreement of States to a most-favoured-nation clause.

9. Nor do the draft articles purport to resolve concrete issues of international trade policy. The draft articles do not purport to establish the principles or rules under which trade occurs. The International Law Commission has recognized that such issues may be addressed by States in other fora. <sup>7/</sup>

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<sup>5/</sup> These comments are collected in A/36/145 and compiled analytically in A/36/146.

<sup>6/</sup> Report of the International Law Commission on the work of its thirtieth session, supra n. 1, commentary to draft art. 29.

<sup>7/</sup> Ibid., para. 62.

III. THREE ILLUSTRATIVE ISSUES RELEVANT TO INTERNATIONAL TRADE

10. The comments and observations on the ILC draft articles submitted in writing thusfar to the General Assembly by States and organizations, and expressed orally before the Sixth Committee during the thirty-fifth and thirty-sixth sessions of the General Assembly, do not reveal major disagreement on the principles behind many of the provisions in the International Law Commission's draft articles. There are, however, some significant issues in connexion with the draft articles concerning which substantial differences of opinion have been expressed. The following are examples of such issues: 8/

(a) whether a text on most-favoured-nation clauses should apply to most-favoured-nations clauses in relations involving economic groupings of States;

(b) whether a text on most-favoured-nation clauses should imply an exception from the operation of a most-favoured-nation clause for benefits granted among members of a customs union or a free trade area;

(c) whether a text on most-favoured-nation clauses should contain provisions for interpreting most-favoured-nation clauses which grant conditional most-favoured-nation treatment.

Even as to these issues, however, the Commission might consider it possible to agree on general comments and observations. The following observations concerning these issues might be helpful to the Commission in this regard.

A. Application of text on most-favoured-nation clauses to clauses in relations involving economic groupings of States

11. According to draft articles 1 and 6, the application of the ILC draft articles would be restricted to most-favoured-nation clauses in relations of States as between themselves. In previous comments and observations on the draft articles, several States and some intergovernmental organizations have pointed out that economic groupings of States are assuming greater importance in the international economy, and that one of these groupings in particular (the European Economic Community), which accounts for a significant portion of world trade, concludes trade treaties containing most-favoured-nation clauses. It has been suggested that a text on most-favoured-nation clauses should also apply to most-favoured-nation clauses in relations involving such economic groupings, in order to render the text complete and to have it accord with actual practice in international commerce.

12. The International Law Commission originally took up its study of most-favoured-nation clauses as an aspect of the general law of treaties, and its draft articles on most-favoured-nation clauses are designed to be interpreted

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8/ In resolution 36/111 of the General Assembly also requested States to comment on the recommendation of the International Law Commission that the draft articles on most-favoured-nation clauses should be recommended to Member States of the United Nations with a view to the conclusion of a convention on the subject. Since this request was directed to States, the Commission may consider it unnecessary to consider the question of the form that a text on most-favoured-nation clauses might take.

in light of the Vienna Convention on the Law of Treaties. <sup>9/</sup> Accordingly, the International Law Commission has restricted the scope of application of its draft articles on most-favoured-nation clauses to correspond with a similar restriction in article 1 of the Vienna Convention. <sup>10/</sup>

13. From a strictly legal viewpoint, however, a text on most-favoured-nation clauses need not necessarily be restricted to clauses in relations between States. A most-favoured-nation clause is normally only one provision in a trade agreement. Issues concerning the treaty as a whole (i.e. conclusion, entry into force, observance, application, interpretation, invalidity, termination etc.) would be governed by legal rules independent of a text on most-favoured-nation clauses. A text concerning the interpretation and application of most-favoured-nation clauses might be structured so as not to affect the law governing these issues.

14. One objection to the application of a text on most-favoured-nation clauses to clauses in relations involving economic groupings of States, expressed during consideration of the ILC draft articles in the Sixth Committee, was based on the view that "supranational organizations" should not be placed on the same level as sovereign States. In international practice, however, it may become more common for economic groupings to become parties to trade treaties with States. The application of a text on most-favoured-nation clauses to assist in the interpretation and application of most-favoured-nation clauses in relations involving such economic groupings need not presuppose or imply an equation of the economic grouping with sovereign States.

B. Benefits granted among members of a customs union or a free trade area

15. Several comments and observations on the ILC draft articles submitted thusfar have suggested that a text on most-favoured-nation clauses should exclude from the operation of a most-favoured-nation clause benefits which a contracting party to the clause accords pursuant to its membership of a customs union or free trade area. Proponents of such an exception have argued that members of a customs union or a free trade area do not intend the benefits which members grant to each other to extend to non-members through most-favoured-nation clauses - that this would be inconsistent with the purpose of a customs union or a free trade area; and that without such an exception it would be impossible to create a customs union or a free trade area. It has also been contended that the existence of such an exception can be implied in customary international law.

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<sup>9/</sup> Report of the International Law Commission on the work of its thirtieth session, supra n. 1, para. 59.

<sup>10/</sup> The International Law Commission is currently in the process of elaborating a new text dealing with treaties concluded between States and international organizations or between two or more international organizations. At its thirty-third session, the International Law Commission completed its second reading of 26 draft articles on this topic. Report of the International Law Commission on the work of its thirty-third session, 4 May-24 July 1981, para. 105. (Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 10, A/36/10.)

16. An opposing view has argued that the existence of such an exception would favour one group of States at the expense of others, and that the exception does not constitute a generally recognized norm of international law.

17. A majority of commercial treaties containing a most-favoured-nation clause expressly excludes from the operation of the clause benefits granted by a contracting party pursuant to its membership in a customs union or a free trade area. Most world trade is conducted under rules providing for most-favoured-nation treatment which is subject to an express exception to that effect. <sup>11/</sup> The underlying issue, therefore, is whether, with respect to those most-favoured-nation clauses which are silent as to the existence or non-existence of such an exception, the exception should be implied.

18. At its thirtieth session, the International Law Commission had before it a proposal to include in the draft articles a provision dealing with this issue in order to assist in the interpretation and application of such most-favoured-nation clauses. <sup>12/</sup> The International Law Commission agreed not to include such a provision in the draft articles, citing the inconclusiveness of the comments made thereon and the lack of time to consider the matter. The International Law Commission emphasized, however, that the silence of the draft articles on this subject could not be interpreted as an implicit recognition of the existence or non-existence of such a rule but should, rather, be interpreted to mean that the ultimate decision was one to be taken by the States to which the draft was submitted at the final stage of the codification of the topic. <sup>13/</sup>

19. In connexion with this issue the following points may be noted:

(a) A term in a text on most-favoured-nation clauses providing for the implied exception would merely assist in the interpretation and application of those most-favoured-nation clauses in which the parties had not expressly stated whether customs union or free trade area benefits are to be included in or excluded from the operation of the clause. The parties to a most-favoured-nation clause could, if they so agreed, override this provision by stipulating in the clause whether or not benefits granted pursuant to a customs union or a free trade area are to be included in the operation of the clause. Draft article 29 provides that the draft articles "are without prejudice to any provision on which the granting State and beneficiary State may otherwise agree."

(b) A text on most-favoured-nation clauses could be made non-retroactive (as are the ILC draft articles pursuant to draft article 28). Such a text would apply only to most-favoured-nation clauses in treaties which are concluded after the text became effective. Parties negotiating a most-favoured-nation clause subsequent to the coming into effect of a text on most-favoured-nation clauses which provides for the implied exception would therefore be able to take this provision into account in deciding whether to have the most-favoured-nation clause expressly include or exclude customs union or free trade area benefits.

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<sup>11/</sup> E.g., art. XXIV of the General Agreement in Tariffs and Trade (GATT), which accounts for a major portion of world trade, and most-favoured-nation clauses in bilateral treaties.

<sup>12/</sup> Report of the International Law Commission on the work of its thirtieth session, *supra* n.1, para. 57.

<sup>13/</sup> *Ibid.*, para. 58.

(c) In most cases, a State which is a member of a customs union or a free trade area would take this membership, and its attendant obligations, into account in its subsequent negotiation of a most-favoured-nation clause with a non-member. A text on most-favoured-nation clauses might therefore provide for the implied exception only in respect of benefits accorded pursuant to a customs union or free trade area to which a party becomes a member after it enters into the treaty containing the most-favoured-nation clause. If this approach were adopted, and if a text on most-favoured-nation clauses were not to apply retroactively, then developing countries might conclude that the implied exception would not prejudice their interests. This would be true particularly if developing countries believe that they are more likely to engage in economic integration in the future than are developed countries.

(d) A provision in a text on most-favoured-nation clauses providing for the implied exception could be made subject to conditions, such as one providing for negotiations aimed at resolving the conflicting interests of the party which joins a customs union or free trade area, and the beneficiary of the most-favoured-nation clause. The implied exception might also be subject to provisions designed to accommodate the special circumstances of developing countries.

C. Conditional most-favoured-nation clauses

20. The ILC draft articles contain provisions designed to assist in the interpretation and application of most-favoured-nation clauses which are made subject to conditions of compensation and reciprocal treatment (draft articles 12 and 13). Many comments and observations on the draft articles submitted thusfar have objected to such provisions, contending, in essence, that conditional most-favoured-nation clauses should not be used in international relations.

21. According to draft articles 11 and 15, most-favoured-nation treatment would not be conditional unless the parties to a most-favoured-nation clause make it conditional. The International Law Commission has concluded that the traditional type of conditional most-favoured-nation clause "has almost disappeared from the international scene" 14/ and "is now largely of historical significance". 15/ However, the International Law Commission included draft articles 12 and 13 to serve as an aid to interpreting clauses conditioned on compensation or reciprocity in case the parties to a treaty agree to a most-favoured-nation clause containing such conditions. 16/ If a text on most-favoured-nation clauses were to include provisions comparable to draft articles 12 and 13, the text could perhaps make it clear that such provisions are only to assist in the interpretation and application of a most-favoured-nation clause which the parties themselves have agreed to make conditional, and are not to be deemed to endorse the use of conditional most-favoured-nation clauses in international relations.

22. It might even be possible for a text on most-favoured-nation clauses to accomplish the interpretative objective of draft articles 12 and 13 without making specific reference to clauses conditioned upon compensation or reciprocity.

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14/ Ibid., commentary to draft arts. 11, 12 and 13, para. 10.

15/ Ibid., commentary to draft arts. 11, 12 and 13, para. 11.

16/ Ibid.

The principle behind draft articles 12 and 13 is, in essence, that a beneficiary under a most-favoured-nation clause would be entitled to most-favoured-nation status only in accordance with the terms and conditions to which the parties to the clause have agreed. The statement of such a principle in general terms 17/ might make it possible to avoid the inclusion of provisions such as draft articles 12 and 13. Under this approach a text on most-favoured-nation clauses could accomplish the aims of draft articles 12 and 13 without appearing to sanction or endorse most-favoured-nation clauses conditioned on compensation or reciprocity.

#### IV. PROCEDURE FOR PREPARATION OF RESPONSE TO REQUEST OF GENERAL ASSEMBLY

23. The Commission, in response to the General Assembly's request to assist in the project of harmonizing and unifying the law relating to the interpretation and application of most-favoured-nation clauses, may wish to consider the formulation of comments and observations on the ILC draft articles from the point of view of the progressive harmonization and unification of this aspect of the law of international trade.

24. The General Assembly in resolution 36/111 has requested written comments and observations by 30 June 1983. Therefore, the substance of the response could be considered and finalized at the sixteenth session of the Commission. At the present session, the Commission may wish to consider how to proceed in the formulation of written comments and observations.

25. The Commission may consider it appropriate to make general comments on the ILC draft articles, or on particular draft articles. This suggested approach was followed by intergovernmental organizations 18/ and the United Nations organ 19/ which have already submitted written comments and observations on the draft articles.

26. In deciding how to proceed in response to the request of the General Assembly, the Commission might wish to consider the following possibility. If the Secretariat were so authorized by the Commission at its fifteenth session, the Secretariat could, subsequent to that session, prepare a draft of comments and observations on the ILC draft articles. In doing so, the Secretariat would take into account the various views concerning the draft articles which have been expressed thusfar, and attempt to propose possibilities for agreement on general comments concerning the ILC draft articles which would be consistent with the interests of States and with the goal of the progressive harmonization and unification of this area of international trade law. The draft comments and observations could be issued in sufficient time for States to consider them prior to the sixteenth session of the Commission. The draft comments and observations could be placed before the Commission at its sixteenth session, at which time the Commission could consider and finalize the substance of any comments and observations that it deems appropriate.

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17/ See draft art. 14.

18/ A/35/203 and Add.1 and 2; A/36/145.

19/ A/36/145, section III.

ANNEX

RESOLUTION ADOPTED BY THE GENERAL ASSEMBLY

36/111. Consideration of the draft articles on  
most-favoured-nation clauses

The General Assembly,

Recalling its resolution 33/139 of 19 December 1978 relating to the report of the International Law Commission on the work of its thirtieth session, 1/ in particular section II of the resolution,

Recalling also its resolution 35/161 of 15 December 1980, entitled "Consideration of the draft articles on most-favoured-nation clauses",

Reaffirming its appreciation of the high quality of the work done by the International Law Commission in elaborating a series of draft articles on most-favoured-nation clauses,

Bearing in mind the importance of facilitating international trade and development of economic co-operation among all States on the basis of equality, mutual advantage and non-discrimination in the establishment of the new international economic order,

Having considered the item entitled "Consideration of the draft articles on most-favoured-nation clauses", including the report of the Secretary-General 2/ and the analytical compilation of comments and observations from Governments, organs of the United Nations which have competence in the subject-matter and interested intergovernmental organizations, 3/ submitted pursuant to paragraphs 3 and 4 of General Assembly resolution 35/161,

Taking note of the comments and observations submitted, in particular those relating to outstanding issues,

Aware of the fact that more replies from States and interested intergovernmental agencies are needed,

1. Requests the Secretary-General to reiterate his invitation to Member States, interested organs of the United Nations, such as the regional commissions and the United Nations Commission on International Trade Law, as well as interested intergovernmental organizations, to submit or bring up to date, not later than 30 June 1983, any written comments and observations which they deem appropriate on chapter II of the report of the International Law Commission on the work of its thirtieth session, in particular on:

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1/ Official Records of the General Assembly, Thirty-third Session, Supplement No. 10 (A/33/10).

2/ A/36/145.

3/ A/36/146.

(a) The draft articles on most-favoured-nation clauses adopted by the International Law Commission;

(b) Those provisions relating to such clauses on which the International Law Commission was unable to take a decision;

and also requests States to comment on the recommendation of the International Law Commission that those draft articles should be recommended to Member States with a view to the conclusion of the convention on the subject;

2. Decides to consider the substance of the draft articles on most-favoured-nation clauses, together with any amendments thereto, at its thirty-eighth session with a view to taking a decision thereon;

3. Decides to include in the provisional agenda of its thirty-eighth session the item entitled "Consideration of the draft articles on most-favoured-nation clauses" and to consider it as a matter of priority.

92nd plenary meeting  
10 December 1981