The Return of Voluntary Export Restraints? How WTO Law Regulates (and Doesn't Regulate) Bilateral Trade-Restrictive Agreements

Vidigal, G.

Publication date
2019
Document Version
Proof
Published in
Journal of World Trade
License
Other

The Return of Voluntary Export Restraints? How WTO Law Regulates (And Doesn't Regulate) Bilateral Trade-Restrictive Agreements

Geraldo VIDIGAL*

In recent trade negotiations, WTO Members have consented to limit rather than promote trade between the parties, bringing back the spectre of 'voluntary export restraints', a widespread practice of the 1980s that was outlawed in the Uruguay Round Agreements. This article discusses the ways in which WTO law regulates, and does not regulate, agreements between WTO Members to limit parties' rights under WTO law ('WTO-minus'). While WTO-minus provisions in bilateral agreements are able to influence WTO law only under very specific circumstances, the design of WTO dispute settlement is such that measures based on WTO-minus arrangements may remain unopposed for long periods of time. If trade-restrictive measures are challenged, WTO-minus provisions are unlikely to serve as a defence before WTO adjudicators.

1 INTRODUCTION

On 3 September 2018, six years after the Free Trade Agreement Between the United States of America and the Republic of Korea (KORUS) entered into force, the parties published the agreed texts giving legal form to the renegotiated KORUS.[1] From the text, a crucial part is missing: under the new arrangement as announced in March the same year, besides providing advantages in market access to the US, Korea had agreed to 'an arrangement with respect to steel imports':[2] to reduce its exports of steel to the United States to 70% of the average of the previous three years. This reduction was explicitly

* Assistant Professor, University of Amsterdam. Email: g.vidigal@uva.nl.

1 The texts are at https://www.strtrade.com/media/publication/7800_KORUS_Texts_Outcomes.pdf (accessed 20 Sept. 2018).

2 United States Trade Representative, *Joint Statement by the United States Trade Representative Robert E. Lighthizer and Republic of Korea Minister for Trade Hyun Chong Kim* (Mar. 2018), https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/Mar./joint-statement-united-states-trade (accessed 20 Sept. 2018).

Vidigal, Geraldo. 'The Return of Voluntary Export Restraints? How WTO Law Regulates (And Doesn't Regulate) Bilateral Trade-Restrictive Agreements'. *Journal of World Trade* 53, no. 2 (2019): 187–210.

linked to Korea's exemption from the US's announced extraordinary 25% tariffs on steel.[3]

This understanding did not come as a surprise. Shortly after taking office in 2017, President Trump withdrew his country's signature from the Trans-Pacific Partnership, an agreement that had been considered as the harbinger of a new generation of trade rules,[4] and announced his intention to revise US trade relations with a number of countries, with an overall aim of 'trade deficit reduction'.[5] The means envisaged included both revising existing Free Trade Agreements (FTAs) that the new US President felt hurt US producers and workers – besides KORUS, the North American Free Trade Agreement (NAFTA) was specifically mentioned[6] – and starting fresh talks with WTO Members, such as Japan, the European Union and (once it is out of the EU) the United Kingdom, with which the US currently does not have an FTA.[7]

The KORUS renegotiation confirms that, besides curbing protectionism abroad, the new approach also involves asking the US's trade partners to agree to limit their exports to the US market. Thus, the US's 'new FTAs' may go beyond rolling back existing preferences and include provisions that limit rather than promote trade between the parties. In addition to the explicit renegotiation under KORUS, the US is now applying quotas on the steel and aluminium exports of Brazil and Argentina – an outcome these two Members reportedly accepted in order to be excluded from the application of 25% additional tariffs on their steel and 10% on their aluminium exports. While Argentina agreed to quotas in both steel and aluminium,[8] Brazil's press release on the issue explicitly states that, 'representatives of the steel sector informed that the imposition of quotas would be less restrictive than the 25% tariff', while the aluminium producers 'indicated that the less harmful alternative to their interests was to endure the additional tariffs of 10%'.[9] This indicates that Members were faced with a choice between having their exports subject to

---

3 Andrew Salmon, *Korea Evades Steel Tariffs, Wins Quota from US in Quick FTA Tweak*, Asia Time (26 Mar. 2018).

4 Peter Baker, *Trump Abandons Trans-Pacific Partnership, Obama's Signature Trade Deal*, New York Times (23 Jan. 2017).

5 *Trump Administration Sketches Out 'Model' Trade Agreement*, bilaterals.org (22 Mar. 2017), http://www.bilaterals.org/?trump-administration-sketches-out (accessed 20 Sept. 2018); *Done Deals: The Trump Administration Will Review all of America's Trade Deals*, The Economist (25 Mar. 2017).

6 William Mauldin, Paul Vieira & Juan Montes, *Trump Nafta Blueprint Raises Concerns in Canada and Mexico*, The Wall Street Journal (30 Mar. 2017); Song Jung-a, *US to Renegotiate South Korea Trade Pact*, Financial Times (18 Apr. 2017).

7 Anna Fifield, *Pence Pushes Japan to Start Trade Talks, Tells South Korea to Brace for Review of Current Deal*, Washington Post (18 Apr. 2017); James Dean, *Trump Puts EU Ahead of Britain in Trade Queue* (22 Apr. 2017).

8 Maria Julieta Rumi, *Sin aranceles pero con cupo, las claves del acuerdo por el acero con EE.UU.*, La Nación (1 May 2018).

9 Minister of Foreign Affairs and Minister of Industry, Foreign Trade and Services of Brazil, *American Restrictions on Steel and Aluminum Exports*, Press Release No 123 (2 May 2018).

additional tariffs or being exempted from the tariffs and accepting the application of quotas

To complicate matters, it may be that the record in writing of WTO-minus provisions will remain unclear. Neither the documents reform published in September 2018 that give legal form to the KORUS renegotiation agreement[10] nor the USTR's fact sheet on the agreement between the US–Mexico regarding NAFTA renegotiations[11] explicitly mention the widely reported intention of the governments involved to agree to WTO-minus provisions. Besides the Korean restrictions on steel exports,[12] these include the agreement by Mexico and Canada to accept a quota their duty-free exports to the US, above which vehicles would pay not the US's WTO-scheduled 2.5% tariff but a 25% tariff.[13] In the final U.S.-Mexico-Canada Agreement (USMCA) signed 30 November 2018, this agreement was formalized as two side letters issued by the United States. In them, the United States agrees not to apply to autos and auto parts imported from Mexico and Canada additional tariffs imposed on the basis of its national security legislation (Section 232 of the Trade Expansion Act of 1962). In other words, it establishes an 'extra-national security quota' for these two countries, of up to 2,600,000 passenger vehicles annually, an unlimited amount of light trucks, and auto parts worth up to 108 billion dollars for Mexico, 32.4 for Canada. Brazil's press release, issued after it agreed to the imposition of quotas on Brazilian steel, informed that 'any restrictive measure to be adopted will be under the sole responsibility of the US government'.[14]

Thus, the current set of WTO-minus arrangements include not only agreements that explicitly aim to limit trade but also arrangement whereby exporters tolerate WTO-inconsistent measures by importers, echoing the 'voluntary export restraint' arrangements (VERs) that became common in the 1980s.

This article examines, in light of these developments, the extent to which WTO rules restrict the ability of Members to agree on trade-restrictive provisions bilaterally. These provisions, labelled by the GATT Contracting Parties 'grey area' measures, were prohibited as part of the Uruguay Round Agreements. This prohibition, reflected in both the Agreement on Safeguards and the Dispute

---

10 *See* n. 1.

11 United States Trade Representative, *United States–Mexico Trade Fact Sheet: Rebalancing NAFTA to Support Manufacturing* (27 Aug. 2018), www.sice.oas.org/TPD/NAFTA/Modernization/USA_MEX_Fact_Sheet_Manufacturing_e.pdf (accessed 2018).

12 Salmon, *supra* n. 3.

13 David Shepardson & Ana Isabel Martinez, *Mexico-U.S. Accords Include Mexican Auto Export Cap: Sources*, https://www.reuters.com/article/us-trade-nafta-autos-mexico-exclusive/mexico-u-s-accords-include-mexican-auto-export-cap-sources-idUSKCN1LD2PK (accessed 20 Sept. 2018).

14 Minister of Foreign Affairs and Minister of Industry, Foreign Trade and Services of Brazil, *supra* n. 9.

Settlement Understanding, pursues an essential objective of the WTO when compared to the GATT: going beyond setting out substantive rules to govern trade matters and establishing an institutional forum for Members to negotiate their trade relations. To give effect to this objective of creating a unified legal regime, the WTO rules establish specific multilateral procedures to be followed in order to diminish Members' commitments under WTO law, preventing Members from achieving the same results through bilateral agreements.

Following this introduction, the article proceeds in four sections. Section 2 presents the controversy regarding the relationship between the multilateral trading system and bilateral agreements. Section 3 argues that a number of substantive provisions in WTO law prohibit bilateral agreements that restrict trade in contravention of WTO rules, and that these prohibitions are part of a broader object and purpose of WTO Agreements: the institutionalization of trade relations through the WTO. Section 4 analyses the means by which bilateral agreements may nonetheless affect trade relations, influencing the interpretation of WTO rules, establishing temporary restrictions on the ability of Members to bring certain claims before WTO adjudicators, or creating alternative arrangements that, due to the design of DSU dispute settlement, can be applied de facto by Members. Section 5 concludes.

2 VOLUNTARY EXPORT RESTRAINTS AS WTO-MINUS PROVISIONS

2.1 Deviating from WTO law: WTO-plus, WTO-extra and WTO-minus

Ever since its inception in 1947, the multilateral regime governing international trade relations coexists with arrangements between its participants that deviate from the general rules. The 1947 General Agreement on Tariffs and Trade (GATT) was itself the result of negotiations in which one of the key questions concerned the scope for permissible deviations from the MFN rule, which in principle prohibits all discrimination between participants to the multilateral regime.[15] The result of these negotiations was GATT Article XXIV, which allows two parties to offer preferential trade conditions to each other by entering into free-trade areas and customs unions (jointly referred to as 'free trade agreements' or FTAs). GATT Article XXIV permitted Contracting Parties to offer each other preferences as long as they did so with respect to 'substantially all the trade'.[16]

---

[15] Douglas A. Irwin, Petros C. Mavroidis & Alan O. Sykes, *The Genesis of the GATT* (CUP 2008); Kerry Chase, *Multilateralism Compromised: The Mysterious Origins of GATT Article XXIV*, 5 World Trade Rev. 1 (2006).

[16] General Agreement on Tariffs and Trade, Articles XXIV:8(a)(i), XXIV:8(b).

When the WTO was established, its Members both reaffirmed this GATT provision (incorporating it into the GATT 1994) and inserted an equivalent provision into the General Agreement on Trade in Services (GATS). Additionally, since 1979 the Enabling Clause allows developing countries to enter into preferential agreements among themselves that do not meet the criteria laid out in GATT Article XXIV. In other words, among developing countries – and only among developing countries – partial FTAs are permissible.[17]

The literature on FTAs mostly worries that these agreements undermine the principle of multilateralism that guides the WTO. By allowing Members to grant preferences to some of their WTO partners only, FTAs may encourage imports not from the most efficient producer but from the one with access to trade preferences, leading to so-called 'trade diversion'[18] and decreasing rather than increasing overall welfare. Trade diversion may in turn generate political pressure for the non-extension of the favourable treatment to more efficient Members, with the consequence that FTAs become 'stumbling blocs' rather than 'building blocs' for trade liberalization,[19] undermining multilateral cooperation and acting as 'termites' in the multilateral trading system.[20]

While subsequent research shows that FTAs act largely as building blocks,[21] they have also been considered problematic because they might undermine the role of the WTO as the 'common institutional framework for the conduct of trade relations' between its Members.[22] Given the difficulty of negotiating new rules among the WTO's 160-odd Members, Members increasingly employ FTAs not just to agree on tariff liberalization but to agree on new rules. Horn, Mavroidis and Sapir found that in recent FTAs Members not only agree on WTO-*plus* rules but also on what they label WTO-*extra* rules. WTO-plus commitments are those that go further than WTO obligations in topics already covered by WTO law, while WTO-extra rules go beyond the scope of WTO law, establishing rules on matters such as competition, investment, and labour and environmental protection.[23] WTO-extra provisions challenge the WTO not so much because they conflict with WTO rules as because they establish an alternative institutional setting for the

---

17 GATT Contracting Parties, Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, Decision of 28 Nov. 1979 (L/4903).

18 Jacob Viner, *The Customs Union Issue* (Carnegie Endowment for International Peace 1950).

19 Jagdish Bhagwati, *The World Trading System at Risk* (Princeton University Press 1991).

20 Jagdish Bhagwati, *Termites in the Trading System: How Preferential Agreements Undermine Free Trade* (OUP 2008).

21 Richard E. Baldwin & Elena Seghezza, *Are Trade Blocs Building or Stumbling Blocs?*, 25 J. Econ. Integration 276 (2010).

22 Agreement Establishing the WTO, Article II:1.

23 Henrik Horn, Petros C. Mavroidis & André Sapir, *Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements*, 33 The World Economy 1565 (2010).

development of new trade rules. Institutional competition and fragmented rules could end up making trade more difficult rather than easier.

Less attention has been given to a third category of provisions, which may be labelled 'WTO-minus'. These are provisions that decrease instead of increasing trade liberalization. They may allow FTA parties to apply WTO-inconsistent measures, require one or more parties to adopt certain measures which would have the same effect as another FTA party's WTO-inconsistent measure, or preclude parties from resorting to WTO dispute settlement to challenge each other's trade measures. The main question in the case of WTO-minus provisions concerns not the extent to which WTO rules allow FTAs that benefit their parties to the disadvantage of *other* WTO Members, but the extent to which the WTO Agreements limit the freedom of WTO Members to forfeit *their own rights* under the WTO Agreements.

2.2 Vienna Convention on the Law of Treaties: Successive Treaties and *Inter Se* Modifications

WTO-minus provisions present a particularly thorny legal issue. Failing to give effect to these provisions would seem to deny Members one of the central aspects of their sovereignty: the ability to enter into international agreements with other states, and modify these agreements if this is in the mutual interests of the states involved.[24] Under the principle of contractual freedom that prevails in international law, even a court decision does not preclude the parties to the procedure from setting aside the judgment of the court and determining themselves their relationship.[25] The principle of contractual freedom is ordinarily limited solely by the obligation not to impinge on the rights of third states.[26]

The contractual freedom of states is reflected in Articles 30 and 41 of the Vienna Convention on the Law of Treaties (VCLT). Article 30 determines that, in principle, states are free to renegotiate their own commitments towards each other, with the proviso that the rights of third states are not affected this agreement. In principle, this means that even rules agreed to within the framework of a multilateral treaty may be renegotiated between pairs or groups of states ('*inter se*

---

[24] *S.S. 'Lotus' (France v. Turkey)*, PCIJ Ser A No 10 (1927), at 18 ('International law governs relations between independent States. The rules of law binding upon States therefore emanate from their own free will').

[25] *Continental Shelf (Tunisia/Libya) (Revision and Interpretation)*, ICJ Reports 1985, at 192, 219; *Société Commerciale de Belgique* (1939) PCIJ Ser A/B No 78, at 176.

[26] The general rule in this regard is VCLT Art. 34 ('A treaty does not create either obligations or rights for a third State without its consent').

modifications'), without affecting the rights of third states parties to the multilateral treaty.[27]

However, in order to be lawful, *inter se* modifications of multilateral treaties must fulfil the requirements established in VCLT Article 41.[28] Article 41(1) provides:

> Two or more of the parties to a multilateral treaty may conclude an agreement to modify the treaty as between themselves alone if:
>
> (a) the possibility of such a modification is provided for by the treaty; or
> (b) the modification in question is not prohibited by the treaty and:
> (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations;
> (ii) does not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole.

GATT Article XXIV, GATS Article V and the Enabling Clause fall under Article 41(a). They provide for certain specific modifications, allowing Members to agree *inter se* to preferential arrangements which would otherwise impinge on the rights of other WTO Members to MFN treatment. On the other hand, these provisions offer little guidance on how to deal with WTO-minus arrangements. It seems insufficient to refer generally to these provisions, which establish specific rules, and derive from them a comprehensive regulation of WTO-minus provisions, as the Appellate Body appears to have done in *Peru – Agricultural Products*.[29] The fact that WTO law establishes some conditions for Members to agree on WTO-plus arrangements cannot mean that they are automatically prohibited from agreeing to WTO-minus rules. Pursuant to Article 41.1(b), this would only occur if the modification: (a) is prohibited by WTO rules; (b) affects the rights and obligations of other WTO Members; or (c) creates a derogation

---

[27] *See* Surabhi Ranganathan, *Strategically Created Treaty Conflicts and the Politics of International Law* (CUP 2014); International Law Commission, *Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law – Report of the ILC Study Group Finalized by Martti Koskenniemi*, 13 Apr. 2006 (A/CN.4/L.682); Christopher J Borgen, *Resolving Treaty Conflicts* 37 Geo. Wash. Int'l L. Rev. 573 (2005).

[28] VCLT Art. 30(5) specifies that the rule in Art. 30 relating to interactions between multilateral treaties and *inter se* agreements 'is without prejudice to article 41'. In other words, a restriction in Art. 41, including a restriction agreed on by treaty, precludes the application of the general rules on interaction between rules in different treaties that appear in Art. 30.

[29] Appellate Body Report, *Peru – Agricultural Products*, para. 5.113 ('we consider that the proper routes to assess whether a provision in an FTA that may depart from certain WTO rules is nevertheless consistent with the covered
agreements are the WTO provisions that permit the formation of regional trade agreements – namely: Art. XXIV of the GATT 1994, or the Enabling Clause as far as agreements between developing countries are concerned, in respect of trade in goods; and Art. V of the General Agreement on Trade in Services (GATS) in respect of trade in services' [footnote omitted]).

incompatible with the effective execution of the object and purpose of the WTO Agreements as a whole.

2.3 The procedural solution: limitations to the applicable law

Arguments about the ability of WTO Members to 'contract out' of their WTO obligations have often revolved around the capacity of panels and the Appellate Body to give effect to these modifications.[30] This is due to the fact that the provisions of the DSU governing the activity of panels and the Appellate Body require strict adherence by these organs to the terms of the WTO Agreements. The main provision in this regard is DSU Article 3.2, which provides that the WTO dispute settlement system:

> serves to preserve the rights and obligations of Members *under the covered agreements*, and to clarify the *existing provisions* of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations *provided in the covered agreements*. (emphasis added)

The requirement of strict adherence to the WTO Agreement is echoed in DSU Article 19.2, which provides that, 'in their findings and recommendations, the panel and Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements'. Additionally, DSU Article 11, which governs the exercise of jurisdiction by panels, provides that they must assess, with respect to the measures challenged by the claimant, 'the applicability of and conformity with *the relevant covered agreements*'. Finally, Article 3.5 provides that '[a]ll solutions' to matters brought to dispute settlement must be consistent with the WTO Agreements and 'shall not nullify or impair benefits accruing to any Member under those agreements'.

Contrasting with the jurisdictional provisions that apply to other international adjudicators and explicitly allow courts to consider the entirety of the legal relations between parties to a dispute,[31] the DSU appears to limit panels and the Appellate Body to a narrow assessment of WTO rules only. For this reason, it has been argued that WTO adjudicating bodies lack the 'constitutional capacity to

---

[30] *See* Joost Pauwelyn, *Conflicts of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law* 436 (OUP 2003); Gabrielle Marceau, *Conflicts of Norms and Conflicts of Jurisdiction – The Relationship Between the WTO Agreement and MEAs and Other Treaties* 35 JWT 1081, 1095 (2001); Lorand Bartels, *Applicable Law in WTO Dispute Settlement Proceedings* 35 JWT 499 (2001); Joel P. Trachtman, *The Domain of WTO Dispute Resolution*, 40 Harv. Int'l L.J. 333 (1999).

[31] *See* Lorand Bartels, *Jurisdiction and Applicable Law Clauses: Where Does a Tribunal Find the Principal Norms Applicable to the Case Before It?*, in *Multi-Sourced Equivalent Norms in International Law* 115 (Tomer Broude & Yuval Shany eds, Hart 2011).

reach a conclusion that would lead de facto to an amendment of the WTO treaty'.[32] In *Mexico – Soft Drinks*, the Appellate Body hinted at this view, setting aside arguments based on NAFTA obligations because it 's[aw] no basis in the DSU for panels and the Appellate Body to adjudicate non-WTO disputes'.[33]

This may settle the matter from the viewpoint of adjudicators. It is problematic, however, in that it ensures the de facto primacy of WTO law 'in an indirect manner'.[34] An answer restricted to the four corners of WTO law may fail to acknowledge rules that the parties to the dispute might have agreed to subsequently (*lex posterior*) or that apply to specific cases or between specific Members (*lex specialis*). In case of an FTA signed after the conclusion of the WTO Agreements, if WTO Members freely decide to have their relations governed by rules different from the WTO rules, setting aside these provisions in favour of WTO rules arguably implies 'disregard for the sovereign will of the disputing parties'.[35]

More concretely, disregarding WTO-minus provisions on narrow procedural grounds may jeopardize the ability of the the DSB report to settle the dispute, making it only a partial assessment of the matter and allowing the ruling to be challenged before a different adjudicator. DSU Article 23.1 requires WTO Members to have recourse to WTO dispute settlement whenever they 'seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements'. In case the assessment made by WTO adjudicators is avowedly incomplete (because it is an assessment within the 'four corners' of WTO law), this might subsequently allow a party to argue, either before another adjudicator (the International Court of Justice for example) or in understandings with other Members that, although its measure would be prohibited under the WTO Agreements examined in isolation, once the dispute is examined in full and in light of *lex posterior* and *lex specialis* the WTO-inconsistent measure should be considered permissible *under international law*.

Thus, a decision to give precedence to WTO rules merely on the basis of the jurisdictional limitations of WTO adjudicators provides ample margin for legal challenge. A more robust consideration of the matter requires a broader assessment of whether and to what extent the WTO Agreements indeed limit the contractual freedom of Members.

---

[32] Gabrielle Marceau, *Conflicts of Norms and Conflicts of Jurisdiction – The Relationship Between the WTO Agreement and MEAs and Other Treaties* 35 JWT 1081, 1095 (2001).

[33] Appellate Body Report, *Mexico – Soft Drinks*, paras 56, 78.

[34] Bartels, *supra* n. 30, at 507.

[35] Joost Pauwelyn, *How to Win a WTO Dispute Based on Non-WTO Law? Questions of Jurisdiction and Merits*, in At the Crossroads*: The World Trading System and the Doha Round* 1–53, 47 (Stefan Griller ed., Springer 2008).

3 WTO-MINUS PROVISIONS UNDER WTO LAW: SUBSTANTIVE LIMITATIONS AND OBJECT AND PURPOSE

3.1 Explicit limitations to WTO-minus arrangements

Under the general international law rules on treaty modification codified in VCLT Article 41, in order for inter se agreements to be unlawful either they must be specifically prohibited by a multilateral treaty whose rules they purport to modify [Article 41.1(b)(i)] or they must be incompatible with the effective execution of the object and purpose of the multilateral treaty [Article 41.1(b)(ii)]. While the assessment of object and purpose requires a deeper inquiry with regard to the treaty (See section 3.2),[36] a useful starting point is the explicit regulation of WTO-minus agreements in WTO law. This regulation includes one broad prohibition of protectionist arrangements in Article 11.1(b) of the Agreement on Safeguards (AoS) and the adoption of mutually agreed solutions (MASs) that are inconsistent with WTO law (DSU Articles 3(5) and 3(7). Finally, GATT Articles XXIV, GATS Article V and the Enabling Clause are relevant in that they establish specific rules for FTAs.

3.1[a] *The General Prohibition: Article 11.1(b) of the Agreement on Safeguards*

One of the objectives of Members in the Uruguay Round was to curtail resort to so-called 'grey area' measures, i.e. legal arrangements used to circumvent GATT prohibitions on discriminatory and trade-restrictive measures. These arrangements were defined by the GATT Secretariat in a 1987 Note as 'bilateral restraint arrangements … concluded between importing and exporting countries', with varying degrees of government participation, to afford protection to an importing country's domestic industry without this country ostensibly violating GATT rules. Grey area measures were seen by importing countries as 'a pragmatic response to pressure for restrictive action arising from increased imports', and were accepted by exporting countries 'because of the threat that the alternative[] would be unilateral action' from the importing country.[37] They took the form of restrictions set up by the exporting country, or of orderly market arrangements agreed on between the importing and exporting industries. Through grey area measures, Western countries could restrict imports while 'maintain[ing their] free-trade policy, at least in principle'.[38]

---

[36] Isabelle Buffard & Karl Zemanek, *The 'Object and Purpose' of a Treaty: An Enigma?*, 3 Austrian Rev. Int'l & Eur. L. 311 (1988); Jan Klabbers, *Some Problems Regarding the Object and Purpose of Treaties* 8 The Finnish Y.B. Int'l L. 138 (1997).

[37] GATT Secretariat, *'Grey-Area' Measures – Background Note by the Secretariat*, 16 Sept. 1987 (MTN. GNG/NG9/W/6), at 2–4.

[38] Mike Tharp, *U.S. and Japan Agree on Ceilings for Car Shipments Through 1983*, New York Times (1 May 1981).

It is doubtful whether grey area measures were lawful even before the Uruguay Round Agreements. The 1988 Panel in *Japan – Semi-conductors* examined measures taken by Japan pursuant to an agreement with the United States to restrict its exports of semi-conductors and concluded that these measures violated the prohibition imposed by GATT Article XI:1 on 'prohibitions or restrictions other than duties, taxes or other charges' on imports and exports. The Panel concluded that, without enacting any explicit legislation, Japan had introduced a 'complex of measures [which] constituted a coherent system restricting the sale for export … inconsistent with Article XI.1'.[39]

The complainant in *Japan – Semi-conductors* was the European Economic Community, which was a third party to the US–Japan arrangement. The Panel's decision was that the measures taken by Japan to implement the arrangement prejudiced other WTO Members.[40] The Panel's finding confirms that GATT Article XI:1 prohibits grey area measures that negatively affect third parties, but does not touch upon the question whether the US–Japan arrangement itself (which was notified to the GATT Contracting Parties)[41] was compatible with the GATT. GATT Contracting Parties had already decided to discuss disciplines on grey area measures as part of their Uruguay Round negotiations[42] and, at the end of the negotiations, the GATT Director-General reported that the new rules would require 'the eventual elimination of … so-called "grey-area" measures taken outside the GATT rules'.[43]

This requirement was inserted in Article 11.1 of the Agreement on Safeguards, entitled 'Prohibition and Elimination of Certain Measures'. Article 11.1 provides in the relevant part:

> (a) A Member shall not take or seek any emergency action on imports of particular products as set forth in Article XIX of GATT 1994 unless such action conforms with the provisions of that Article applied in accordance with this Agreement.
> (b) Furthermore, a Member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side. These include actions taken by a single Member as well as actions under agreements, arrangements and understandings entered into by two or more Members.

---

39 GATT Panel, *Japan – Semi-conductors*, adopted 4 May 1988 (L/6309 – 35S/116), paras 104, 117.
40 *Ibid.*, para. 96.
41 *Ibid.*, para. 12.
42 GATT Secretariat, *supra* n. 37.
43 Peter D. Sutherland, *A New Framework for International Economic Relations*, 16 June 1994 (GATT/1640), at 6.

Article 11 prohibits Members seeking to afford protection to industries injured or threatened by increases in imports from resorting to measures other than WTO safeguards, which are regulated by GATT Article XIX and the Agreement on Safeguards. This 'flat prohibition of new grey-area measures' is, Alan Sykes notes, the 'centerpiece of the Agreement [on Safeguards]'.[44] It fulfils a key objective stated in its preamble: to 're-establish multilateral control over safeguards and eliminate measures that escape such control'.[45] Thus, Article 11.1(a) requires Members aiming to withdraw or modify concessions to resort to WTO safeguards,[46] Article 11.1(b) prohibits alternative arrangements that lead to the same result, and Article 11.3 prohibits Members from encouraging or supporting the taking of equivalent measures by the industries.

To ensure that no loopholes remain for protectionist measures, Article 11.1(b) is broad in scope. It specifically prohibits voluntary export restraints and orderly market arrangements, two common species of grey area measures, and extends this prohibition to 'any other similar measures'. Footnote 4 clarifies that 'similar measures include export moderation, export-price or import-price monitoring systems, export or import surveillance, compulsory import cartels and discretionary export or import licensing schemes, any of which afford protection'. The prohibition in Article 11.1(b) therefore covers any measures that are similar to voluntary export restraints and orderly market arrangements in that they 'afford protection' to a country's industry, fulfilling the function that should be fulfilled by a WTO-compatible safeguard measure.

Interpreted in light of the context provided by Article 11 as a whole and of the object and purpose of the AoS, Article 11.1(b) prohibits any measure or arrangement – including those agreed bilaterally between an exporter and an importer – that circumvents the WTO disciplines on safeguards and results in the suspension, in whole or in part, of WTO obligations, or withdraws or modifies WTO concessions, affording protection to a domestic industry.

---

44 Alan O. Sykes, *The WTO Agreement on Safeguards – A Commentary* 26 (Oxford University Press 2006).

45 A 1994 Note by the Secretariat stated that the AoS 'prohibits the use of "grey area measures" which escape multilateral control' (Note by the Secretariat, 'A Description of the Provisions Relating to Developing Countries in the Uruguay Round Agreements, Legal Instruments and Ministerial Decisions', 2 Nov. 1994 (COM.TD/W/510)). A report by the GATT Council noted that the AoS 'requires 'that "grey-area" measures not in conformity with the provisions of Article XIX be brought into conformity with the Agreement or phased out within four years after the entry into force of the Agreement Establishing the WTO' (GATT Council Report, *Overview of Developments in International Trade and the Trading System*, 5 Dec. 1994 (C/RM/OV/5), para. 86).

46 Art. 11.1(a) refers the interpreter to GATT Art. XIX. This provision allows a Member 'to suspend … in whole or in part' a WTO obligation or to 'withdraw or modify [a WTO] concession' when as a result of such concessions or obligations, combined with unforeseen developments, 'any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products'.

3.1[b] *Specific Provisions: MASs and FTAs*

Besides the general prohibition in AoS Article 11.1(b), the WTO Agreements regulate MASs and FTAs. In both cases, it precludes the use of these bilateral instruments to 'legalize' between two or a few WTO Members the use of otherwise WTO-inconsistent measures.

MASs are means by which WTO Members may terminate a dispute, whether before or after the Dispute Settlement Body issues a report. DSU Article 3.7 states that the preferred goal of WTO dispute settlement is to lead to an MAS, described as a 'positive solution' that is 'mutually acceptable to the parties to a dispute *and consistent with the covered agreements*' (emphasis added). Additionally, Article 3.5 of the DSU provides:

> *All solutions* to matters formally raised under the consultation and dispute settlement provisions of the covered agreements, including arbitration awards, *shall be consistent with those agreements* and shall not nullify or impair benefits accruing to any Member under those agreements, nor impede the attainment of any objective of those agreements. (emphasis added)

Thus, in order to constitute an MAS, an agreement must not only lead to a solution considered positive by the parties but must also be consistent with the WTO Agreements. In *Peru – Agricultural Products*, the Appellate Body rejected the argument that an agreement that allows the taking of a WTO-inconsistent measure constituted a 'positive solution' to the dispute, precluding resort to dispute settlement.[47] This limitation applies equally to 'mutually satisfactory solutions' reached under DSU Article 22.8, after the DSB has authorized suspension of concessions and other obligations. In *Canada/US – Continued Suspension*, the Appellate Body noted that a MAS only leads to the expiry of the authorization for retaliation if it leads to the 'substantive resolution of the inconsistency found by the DSB'.[48] Enshrining a WTO-minus provision within a purported MAS therefore does not necessarily legitimize its content.

In addition to MASs, the WTO Agreements establish specific rules for FTAs (encompassing free trade areas and customs unions for goods but also agreements for mutual elimination of barriers to trade in services). FTAs are governed by GATT Article XXIV with respect to trade in goods and by Article GATS Article V with respect to trade in services. The Enabling Clause establishes rules for FTAs to which only developing countries are parties.

Pursuant to GATT Article XXIV, WTO Members may enter into preferential agreements, as long as the resulting arrangement: (a) eliminates trade barriers on

---

[47] Appellate Body Report, *Peru – Agricultural Products*, para. 5.26.

[48] Appellate Body Report, *US/Canada – Continued Suspension*, para. 310. However, 'a decision of the DSB is not required if Members reach a mutually agreed solution' (*Ibid.*, para. 389).

'substantially all the trade' in goods between the participants[49]; and (b) does not lead to the application to third WTO Members of tariffs and trade barriers that are on the whole 'higher or more restrictive' than those that applied prior to the arrangement.[50] Similarly, GATS Article V covers agreements on services which eliminate 'substantially all' discrimination in a 'substantial' share of the trade in services between the parties and do not 'raise the overall level of barriers to trade in services' applied to third WTO Members.[51] The Enabling Clause allows developing countries to enter into preferential agreements in goods among themselves which do not meet the criteria laid out in GATT Article XXIV.

GATT Article XXIV and GATS Article V are worded as exceptions, stating that under certain conditions WTO rules 'shall not prevent' Members from entering into FTAs. In *Peru – Agricultural Products* the Appellate Body appears to concluded that GATT Article XXIV might justify a WTO-minus provision if (a) the provision is introduced upon the formation of an FTA, and (b) the formation of the FTA would be prevented if the provision could not be included in the agreement.[52] However, the Appellate Body also noted that Article XXIV does not provide 'a broad defence for measures in FTAs that roll back on Members' rights and obligations under the WTO covered agreements'.[53]

A possible justification for a WTO-minus provision, therefore, is that it contributes to the objective of FTAs as established in the WTO Agreements: trade liberalization. GATT Article XXIV:4 provides that the objective of FTAs is 'to facilitate trade', and that unions or FTAs are 'agreements[] of *closer* integration between the economies of the countries parties to such agreements'.[54] On the basis of this provision, in Peru – Agricultural Products the Appellate Body rejected the possibility that Peru might be exempted from one of its WTO obligations by a WTO-minus provision in an FTA, or have the obligations interpreted in a way that, due to an FTA, would only 'apply between some of its parties'.[55] This would seem to preclude most WTO-minus provisions, and certainly those that seek to impose further trade barriers or legitimize one of the parties adopting against the other trade-restrictive measures that would be impermissible under WTO law.

---

49 GATT, Article XXIV:8.
50 GATT, Article XXIV:5.
51 GATS, Articles V:1, V:4.
52 Appellate Body Report, *Peru – Agricultural Products*, para. 5.115. *See also* Appellate Body Report, *Turkey – Textiles*, para. 58.
53 Appellate Body Report, *Peru – Agricultural Products*, paras 5.115–5.116.
54 Appellate Body Report, *Peru – Agricultural Products*, para. 5.116.
55 Appellate Body Report, *Peru – Agricultural Products*, paras 5.95.

3.2 WTO-minus provisions and the object and purpose of the WTO Agreements

3.2[a] *WTO-minus Measures That Facilitate Trade and the Object and Purpose of Article XXIV*

Some have interpreted the Appellate Body report in *Peru – Agricultural Products* as leaving 'no remaining avenue' for the Appellate Body to accept a WTO-minus modification of WTO Agreements between parties to an FTA.[56] However, the Appellate Body does seem to have left a door open for WTO-minus modifications. It noted that, pursuant to GATT Article XXIV:4:

> the purpose of a customs union or FTA is 'to facilitate trade' between the constituent members and 'not to raise barriers to the trade' with third countries … paragraph 4 qualifies customs unions or FTAs as 'agreements, of *closer* integration between the economies of the countries parties to such agreements'.[57]

In principle, then, a Member might be able to demonstrate that a trade-restrictive measure was required for the formation of an FTA, and is therefore justifiable pursuant to Article XXIV or Article V. On the other hand, WTO-minus provisions would seem to be incompatible with the Enabling Clause, whose paragraph 2(c) only authorizes 'mutual reduction or elimination' of tariffs and non-tariff barriers.

Thus, while Article XXIV is not a 'broad defence for measures that roll back on Members' rights and obligations under the WTO covered agreements',[58] it seems that an FTA provision can curtail the rights of FTA parties under WTO law in order to facilitate trade between the parties or ensure closer integration between the economies of the Members that are parties to the FTA. In terms of provisions, one example seem to be FTAs that limit or eliminate the right of parties to adopt trade remedies measures against each other.[59]

A more complex possibility would be for a Member to be able to apply a trade-restrictive measure in response, for example, to violations of labour rights enshrined in the FTA, or as countermeasures in case of non-compliance with FTA rules. In principle these trade-restrictive measures may be required to enforce the FTA and therefore to ensure 'closer integration' between its parties. However, assessing the lawfulness of the enforcement measure could require a WTO panel or

---

[56] James Mathis, *WTO Appellate Body, Peru – Additional Duty on Imports of Certain Agriculture Products*, WT/DS457/AB/R, 20 July 2015, 43 Legal Issues Econ. Integration 97, 104 (2016).

[57] Appellate Body Report, *Peru – Agricultural Products*, para. 5.116. Similarly, GATS Article V:1 states that it applies to agreements 'liberalizing trade in services'. Para. 1 of the Enabling Clause allows the provision to developing countries of 'differential and more favourable treatment'.

[58] *Ibid*.

[59] *See* the decision creating the EU–Turkey Customs Union (Association Council Decision no 1/95), Art. 44. This would seem to contradict the right of the parties under GATT, Article VI:2.

the Appellate Body to make a finding on the consistency of the original measure with the FTA. While the Appellate Body has rejected the possibility that a WTO adjudicator could make this finding,[60] in case the finding were made by an adjudicator with jurisdiction under the FTA itself the enforcement measure could be seen as necessary to the formation of the FTA, in that not having an enforcement procedure would prevent the closer integration between the parties that FTAs must aim for.

3.2[b] *Institutionalization as Object and Purpose*

In *Peru – Agricultural Products*, the Appellate Body sidestepped the issue of modification under VCLT rules, stating summarily that the WTO Agreements' 'specific provisions addressing amendments, waivers, or exceptions for regional trade agreements … prevail over the general provisions of the Vienna Convention, such as [VCLT] Article 41'.[61] In other words, *inter se* modifications of WTO rules would not be subject to Article 41 at all. Their lawfulness would be assessed entirely under the relevant WTO rules because the legal regime established in the WTO Agreements displaces the general international legal regime for treaty modification entirely.

This conclusion is difficult to justify solely based on the existence of amendment provisions in the WTO Agreements. The VCLT provision governing amendment of multilateral treaties in the absence of specific regulation in the treaty is Article 40, not Article 41. Provisions on amendment therefore displace VCLT Article 40, not Article 41, which exists to preserve the freedom of states to 'contract out' of multilateral treaties. If specific rules on amendment displaced Article 41, most multilateral treaties, which establish amendment procedures, would prevent parties to them from agreeing to *inter se* arrangements. Derogations from such a core rule of international law as contractual freedom would need to be justified under the terms of Article 41 itself.

In the absence of an explicit prohibition under Article 41(1)(b)(i), establishing that WTO-minus *inter se* modifications are impermissible requires that the prohibition of extra-WTO arrangements be part of a broader legal regime that displaces the contract-type relations the VCLT normally envisages, replacing these contractual relations with institutionalized relations, based on the rules, procedures and institutions established in the WTO Agreements. This in turn would require

---

[60] Appellate Body Report, *Mexico – Soft Drinks*, para. 56.
[61] Appellate Body Report, *Peru – Agricultural Products*, para. 5.112 (footnote omitted).

asserting that an object and purpose of the Agreement Establishing the WTO (AEWTO) is to establish such an institutionalized system.

As stated in its preamble, in replacing the weakly institutionalized GATT with a fully-fledged international organization Members aimed 'to develop an integrated, more viable and durable multilateral trading system',[62] in which the WTO, provides 'the common institutional framework for the conduct of trade relations among its Members'. The WTO not only 'facilitate[s] the implementation, administration and operation' of existing trade rules but also provides 'the forum for negotiations among its Members concerning their multilateral trade relations'.[63]

Procedural provisions on rule modification would then be part of this broader institutional framework. AEWTO Article XI, which governs decision-making, endows the Ministerial Conference with 'exclusive authority' to interpret the WTO Agreements as well as with the power to temporarily waive an obligation imposed on a Member by the WTO Agreements, '[i]n exceptional circumstances' and by a three-quarters majority. It would defeat the 'exclusive authority' of the Ministerial Conference if groups of Members could agree to establish certain particular interpretations applicable among themselves only, or to waive certain obligations vis-à-vis each other, without obtaining the majority's assent.

The Appellate Body hinted at this 'institutional view' in *Japan – Alcohol:*

> in an exercise of their sovereignty, and in pursuit of their own respective national interests, the Members of the WTO have made a bargain. In exchange for the benefits they expect to derive as Members of the WTO, they have agreed to exercise their sovereignty according to the commitments they have made in the WTO Agreement.[64]

Seen in this light, DSU Articles 3.2 and 19.2, which prohibit recommendations and rulings of panels and the Appellate Body that 'add to or diminish the rights and obligations' established in the WTO Agreements, enforce the duty of Members to go through the WTO's institutional framework to obtain a waiver, interpretation or decision.

This would not necessarily mean that WTO Members have forfeited their sovereignty to agree on other matters. The function of the WTO as a multilateral forum is restricted to 'matters dealt with under the [WTO] agreements'.[65] Members may therefore agree on rules in other matters, which may produce an effect on WTO law (See section 4.1). Within the subject area of the WTO Agreements,

---

62 AEWTO, Preamble.
63 AEWTO, Articles III:1, III:2.
64 Appellate Body Report, *Japan – Alcohol*, at 15.
65 AEWTO, Article III:2.

however, Members have established an institutional framework that imposes constraints on their own ability to agree on trade-restrictive arrangements. This restriction is motivated by the GATT experience with grey area measures, which showed that without these prohibitions economically stronger Members could compel weaker Members to agree to forfeit their trade rights, harming both to the credibility of the multilateral system and the WTO objectives of raising standards of living and expanding the production of and trade in goods and services.[66]

4 PERMISSIBLE WTO-MINUS ARRANGEMENTS: TEMPORARY, MULTILATERAL AND TOLERATED

Bilateral legal arrangements can affect the affects rights and obligations established by the WTO Agreements. Non-WTO agreements may affect the interpretation of WTO obligations if they provide evidence of a broader understanding among the Membership regarding their interpretation. Certain temporary bilateral agreements to restrict trade are specifically permitted. Finally, it cannot be excluded that a WTO-inconsistent arrangement may be tolerated by WTO Members. Since WTO rules do not establish any centralized enforcement agent, a formal or informal alternative arrangement may govern trade relations between Members until one of them considers that bringing a dispute would be fruitful.

4.1 Agreements as evidence of multilateral understanding

Pursuant to DSU Article 3.2, WTO dispute settlement serves to clarify the obligations imposed by the WTO Agreements 'in accordance with customary rules of interpretation of public international law', codified in Articles 31–33 of the Vienna Convention on the Law of Treaties. VCLT Article 31(3) requires interpreters to take into account a number of elements external to the treaty: the subsequent practice of the parties to the treaty, any subsequent agreement among them, and other rules of international law applicable between the parties.

Non-WTO agreements, understandings and declarations may affect the interpretation of WTO rules if they constitute subsequent agreements or provide evidence of subsequent practice, and may produce a 'WTO-minus' effect in the

[66] AEWTO, Preamble. In the economics literature, VERs are considered a particularly bad form of protection, leading to reduced trade at the same time as they increase profits both for the domestic and for the foreign firms, at the expense of consumers in the country allegedly protected. *See* Richard Harris, *Why Voluntary Export Restraints Are 'Voluntary'*, 18 Can. J. Econ. 799; B. Peter Rosendorff, *Voluntary Export Restraints, Antidumping Procedure, and Domestic Politics*, 86 Am. Econ. Rev. 544, 546 (1996); Alan O. Sykes, *The WTO Agreement on Safeguards – A Commentary* 21–26 (Oxford University Press 2006). 1985.

sense of justifying the adoption of trade-restrictive measures that would have been prohibited were it not for an interpretation made in light of these instruments. In *US – Shrimp*, the Appellate Body found that emerging environmental concerns of the international community, reflected in international agreements and documents, led to an evolution in the meaning of 'exhaustible natural resources' in GATT Article XX(g), allowing Members to invoke it to justify trade-restrictive measures to conserve living natural resources.[67]

Treaties and other international instruments may also provide grounds for discriminating between Members, products or services. In *EC – Tariff Preferences*, the Appellate Body found that generalized systems of preferences may discriminate between developing countries based on their specific needs. Evidence of what constitutes a 'need' that warrants discrimination can be found 'in the WTO Agreement or in multilateral instruments adopted by international organizations'.[68] In *Argentina – Financial Services*, the Appellate Body reversed the panel's finding that service suppliers based in countries that do not cooperate in the pursuit of certain objectives set out by the Organization on Economic Cooperation and Development and the Financial Action Task Force were 'like' service suppliers based in countries considered to be cooperative. Members may therefore afford less favourable treatment to service suppliers merely because they are based in Members that fail to cooperate with certain legitimate objectives determined by organizations of which only some Members are parties.[69]

Similarly, a critical number of bilateral agreements could be considered as evidence of a certain interpretation or subsequent development. If FTAs consistently provide that trade-restrictive measures are justified in case of non-compliance with certain basic labour rights established in ILO Conventions or core labour standards, for example, this could indicate a common interpretation of permissible grounds for restricting trade. A trade-restrictive measure could then be justified as a means to protect public morals, prevent the use of 'prison' (i.e. unfree) labour or protect human life or health. Although the outcome would be a multilateral change to the interpretation of WTO law for all Members, the evidence leading to it would be not a multilateral instrument but a series of bilateral agreements demonstrating that the interpretation in question is 'the common intention of the parties' to the WTO Agreements.[70]

---

[67] Appellate Body Report, *US – Shrimp*, para. 130.
[68] Appellate Body Report, *EC – Tariff Preferences*, para. 163.
[69] Appellate Body Report, *Argentina – Financial Services*, para. 6.76. But *see ibid*., para. 6.80.
[70] Appellate Body Report, *Peru – Agricultural Products*, para. 5.95. *See* Geraldo Vidigal, *From Bilateral to Multilateral Law-making: Legislation, Practice, Evolution and the Future of* Inter Se *Agreements in the WTO*, 24 EJIL 1027–53 (2013).

4.2 Temporary arrangements under WTO law

In specific situations, the WTO Agreements allow Members to agree on 'WTO-minus' arrangements bilaterally.[71] Besides *inter se* deviations approved by the Membership as a whole, for example through a waiver, two forms of bilateral agreements are specifically permitted. First, the Anti-Dumping Agreement, the Agreement on Subsidies and Countervailing Measures (SCM Agreement) and the Agreement on Safeguards permit exporters and importing Members to agree on trade-restrictive arrangements to avoid trade remedies. Second, the DSU allows parties to a dispute to agree on compensation and MASs, which may lead otherwise WTO-inconsistent measures to be temporarily permitted vis-à-vis the other party to the bilateral arrangement.

Article 8 of the Anti-Dumping Agreement and Article 18 of the SCM Agreement allow, WTO Members to agree bilaterally on alternatives to trade remedies, including one whereby the exporting Member agrees to increase prices of the exported goods to avoid the imposition of trade remedies. Similarly, footnote 3 to the AoS allows safeguards that take the form of quotas to be administer by the exporting Member. In the case of the SCM Agreement and of the AoS, governments of exporting Members may make undertakings or accept quotas without the agreement of their industries.[72] While these forms of voluntary export restraints (VERs) present a risk in that they allow stronger Members to legitimize trade-restrictive measures with the consent of another Member, these provisions both establish limitations for the adoption of these alternative arrangements (such as requiring an affirmative determination that remedies are warranted) and preserve the right of the exporting Member to challenge the relevant measures through WTO dispute settlement, in case it decides that the measures are no longer in its interest.

WTO-minus provisions can also be agreed within compensation arrangements. Compensation, governed by DSU Articles 3.7 and 22.1, is 'a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement'. By definition, compensation involves the complainant accepting the continuation of a WTO-inconsistent measure against a benefit or advantage from the wrongdoer.

Compensation arrangements generally provide for economic advantages, pecuniary payments, or both. Trade preferences were granted in *Japan – Alcoholic Beverages*[73] and *Turkey – Textiles*.[74] In *US – Copyright*, after an initial agreement to

---

[71] To the extent that these arrangements are permitted by WTO rules, they are not WTO-minus in the sense of depriving Members of their full rights under WTO law but in that agreeing to these arrangements would prevent a Member from challenging the legality of the trade-restrictive measures it lawfully consented to..

[72] Panel Report, *EC – Fasteners (China)*, fn. 279.

[73] Minutes of DSB Meeting, 22 Jan. 1998 (WT/DSB/M/41), at 2.

[74] Notification of Mutually Acceptable Solution, 19 July 2001 (WT/DS34/14).

pay a lump sum,[75] the US appears to have paid periodic sums to the EU.[76] In *US – Cotton*, compensation included both periodic pecuniary payments and trade benefits, as well as a provision requiring fresh consultations upon enactment of the successor legislation to the one considered WTO-inconsistent.[77]

Compensation involves an agreement to allow another Member to persist with a measure found to be WTO-inconsistent. A compensation arrangement may preclude resort to WTO dispute settlement by a party that has explicitly undertaken to accept, or not to challenge, the WTO-inconsistent measure object of the arrangement. A Member that did invoke its WTO rights, without demonstrating that the compensation arrangement expired or was not fulfilled by the other party, would likely be failing to engage in dispute settlement in good faith as required by Article 3.10 of the DSU.[78] In *EC – Bananas*, the Appellate Body implied that a Member could relinquish its right to initiate proceedings under Article 21.5 if it had 'clearly stated that it would not take legal action with respect to a certain measure'.[79]

WTO-minus provisions in compensation agreements, however, are valid only for as long as the underlying arrangement complies with the requirements set out in the DSU. In particular, compensation arrangements must be temporary. Compensation is, to borrow an expression used by the Appellate Body to refer to trade retaliation, an 'abnormal state of affairs that is not meant to remain indefinitely'.[80] Arrangements that do not establish a time-frame for compliance could be considered not to fulfil the requirements for a valid compensation arrangement, with the result that they would not prevent a Member from exercising its right to request a compliance panel or seek authorization to retaliate.[81] And an arrangement that aimed to establish WTO-minus rules within a definitive settlement of the dispute would be blocked by the prohibition on WTO-inconsistent MASs.[82]

Could the Member who agreed to the WTO-inconsistent MAS successfully bring a dispute to challenge the underlying measure? Unless it could be demonstrated that that Member had failed to act in good faith pursuant to DSU Article 3.10, it would seem that the answer is affirmative. Rejecting a claim on grounds that the claimant has agreed to a WTO-inconsistent MAS would render useless for that Member DSU Articles 3.5, 3.7 and 22.1, which requires MASs to be WTO-consistent. It would also allow Members to

---

75 Notification of a Mutually Satisfactory Temporary Arrangement, 26 June 2003 (WT/DS160/23).
76 Status Report by the United States, 7 Apr. 2017 (WT/DS160/24/Add.146).
77 Joint Communication from Brazil and the United States, 31 Aug. 2010 (WT/DS267/45), III.3.
78 *See* Appellate Body Report, *EC – Sugar*, para. 312.
79 *See also* Appellate Body Reports, *EC – Bananas III (Art. 21.5 – Ecuador II / Art. 21.5 – US)*, para. 228.
80 Appellate Body Report, *US/Canada – Continued Suspension*, para. 310 (referring to retaliation).
81 In *Mexico – Soft Drinks*, the Appellate Body found that a Member that decides to initiate a dispute 'entitled to a ruling by a WTO panel' (Appellate Body Report, *Mexico – Soft Drinks*, para. 52).
82 *See* s. 3(A)(2).

disregard Article 11.1(b) of the Safeguards Agreement, which prohibits trade-restrictive bilateral arrangements. While bringing a dispute against terms of an MAS may violate the good faith obligation in Article 3.10, this depends on this MAS itself being consistent with the covered agreements.[83]

This conclusion is not incompatible with the Appellate Body's finding, in *EC – Bananas III (Article 21.5 – Ecuador II/Article 21.5 – US)*, that a Member may relinquish its right to have recourse to compliance proceedings under Article 21.5 of the DSU.[84] The parties to a dispute may agree to a settlement that ends the dispute, with the consequence that the claimant forfeits its right to pursue the dispute and request compliance proceedings. This was done by Brazil and the United States in *US – Cotton*.[85] However, this does not deprive the Member of its rights under the DSU. If the claimant subsequently finds that the conduct of the respondent is again in violation of WTO rules, it may bring a new claim, requiring panels and the Appellate Body to assess the legality of the measure afresh rather than compliance with the recommendations and rulings previously adopted.

4.3 Unchallenged agreements and tolerated non-compliance

There are few lawful possibilities for bilateral arrangements to influence the legality of WTO measures. This has not prevented Members from tolerating each other's WTO-inconsistent measures, either due to a semi-formalized side arrangement such as the one agreed on between the US and Korea or due to a non-formalized political decision to allow a Member to maintain WTO-inconsistent measures, as was done by Brazil and Argentina with respect to the US's steel and aluminium tariffs.

In terms of semi-formalized WTO-minus provisions, the settlement of the *US – Clove Cigarettes* dispute involved a Memorandum of Understanding between the United States and Indonesia (MoU). Most of these issues covered by the MoU were unrelated to the original dispute. The US undertook not to challenge Indonesia's ban on the export of minerals and to allow the import of certain car parts from Indonesia under its General System of Preferences. On the subject-matter of the dispute, the United States made a vague pledge not to arbitrarily or unjustifiably discriminate against Indonesian clove cigarettes (the original reason for the measure's WTO-inconsistency).[86] When the parties notified to the DSB that

---

[83] Appellate Body Report, *Peru – Agricultural Products*, paras 5.25–5.26.
[84] Appellate Body Reports, *EC – Bananas III (Art. 21.5 – Ecuador II / Art. 21.5 – US)*, paras 217.
[85] Notification of a Mutually Agreed Solution, 23 Oct. 2014 (WT/DS267/46), at 1.
[86] Memorandum of Understanding between the Government of the United States of America and the Government of the Republic of Indonesia (3 Oct. 2014), https://ustr.gov/sites/default/files/US%20Indo%20MOU.pdf (accessed 20 Sept. 2018).

they had reached a MAS, this communication included neither the MoU nor a commitment by the parties not to take legal action before the WTO.[87]

The member-driven design of the DSU allows WTO-inconsistent measures to remain in place as long as they are not challenged by other Members. DSU Article 3.7 requires ('shall') Members to 'exercise [their] judgement as to whether action under these procedures would be fruitful' before initiating disputes. No 'WTO prosecutor' exists to file claims before the adjudicators based on an independent assessment that a violation has taken place and the DSU does not allow private parties direct access to the dispute settlement system. As a result, WTO-inconsistent measures may subsist as long as the underlying arrangement is acceptable to all the Members.

Tolerance of non-compliance is an integral element of the WTO institutional framework, which aims to provide states with room for manoeuvre in determining their domestic policies. The WTO Agreements contain various safety valves, in the form of exemptions, exceptions, and carve-outs.[88] Toleration of non-compliance provides a safety valve of last resort where no textual valve exists, permitting politically necessary departure from commitments while ensuring that a claimant may ultimately demand that the non-complying Member eliminate the inconsistency.

Perhaps paradoxically, the assumption behind tolerated non-compliance is that adjudicators will, if provoked, disregard the political considerations that led to temporary toleration and affirm the legal provisions in force. As the GATT Panel in *EEC – Bananas* stated, 'the decision of a contracting party not to invoke a right under the General Agreement at a particular point in time could be due to circumstances that change over time', and can 'not reasonably be assumed to be a decision to release that other contracting party from its obligations under the General Agreement'.[89]

In other words, the fact that an unlawful situation is tolerated does not mean that adjudicators should accord legal value to tolerance. The essence of tolerated non-compliance is that Members are provided with breathing space to adopt WTO-inconsistent measures temporarily. This temporary limit can be extended formally though WTO waivers, for example, or informally if the Member in breach of its obligations can reach an alternative settlement with other Members. The role of adjudicators is to ensure that, once the tolerance ends, Members

---

[87] Notification of a Mutually Agreed Solution, 9 Oct. 2014 (WT/DS406/17, G/L/917/Add.1G/SPS/GEN/1015/Add.1, G/TBT/D/38/Add.1).

[88] B. Peter Rosendorff, *Stability and Rigidity: Politics and Design of the WTO's Dispute Settlement Procedure*, 99 Am. Pol. Sci. Rev. 389 (2005); J. Michael Finger, *Flexibilities, Rules, and Trade Remedies in the GATT/WTO System*', in *The Oxford Handbook on the World Trade Organization* 418–40 (Amrita Narlikar, Martin Daunton & Robert M. Stern, OUP 2012).

[89] GATT Panel Report, *EEC – Bananas*, para. 362.

suffering nullification or impairment can enforce WTO commitments through multilateral mechanisms.

5 CONCLUSION

The trade-restrictive WTO-minus arrangements between the United States and a number of other countries likely violate these Members' WTO commitments. The Uruguay Round Agreements limit the ability of WTO Members to modify their rights and obligations in the field of trade by 'contracting out' of their WTO undertakings, with the declared aim of eliminating grey area measures. These limitations may be seen as grounded on a key object and purpose of the WTO Agreements: to ensure that trade relations are institutionalized and negotiations take place within the multilateral framework of the WTO. For this reason, WTO panels and the Appellate Body should not allow the use of FTAs or MASs to enshrine trade-restrictive relations, undermining the balance of rights and obligations under the WTO Agreements.

Arrangements having the effect of restricting the rights of Members under the WTO Agreements can affect WTO obligations to the extent that they are themselves grounded on WTO law, influencing its interpretation or creating temporary alternative arrangements. Trade-restrictive measures may be justified on the basis of a non-WTO agreement if this agreement reflects a multilateral understanding regarding, for example, legitimate grounds for restricting trade or permissible reasons for discriminating between Members, products or situations. Additionally, through temporary arrangements permissible under WTO law, Members may commit to tolerating WTO-inconsistent measures. Finally, the WTO institutional design ensures a degree of tolerance for WTO-inconsistent measures and arrangements. However, WTO rules do not allow Members to roll back on their WTO commitments bilaterally. If a Member considers that challenging a measure is fruitful, and as long as it is acting in good faith, its previous consent to an alternative arrangement with another Member should not prevail over the multilateral decision to prohibit voluntary export restraints and other grey area measures.