

**VOLUNTARY EXPORT RESTRAINT AGREEMENTS:**

**A PERMANENT OR TEMPORARY EXPEDIENT?**

- A Study with Particular Reference to the Canadian  
Experience

by

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**ABSTRACT**

This thesis focuses on the role of voluntary export restraint agreements (VERs) in world trade. Introduced as temporary trade policy measures, VERs have now existed for more than thirty years. Their purpose is to protect domestic industries which are feared to be injured by imports. The coverage of VERs by GATT is not clearly defined. VERs are so-called "grey area" agreements that are widely used as bilateral safeguard measures. Today, about 10 percent of the world trade is affected by VERs.

The influence of VERs on Canadian trade is used as a sample in this study. Their compatibility with GATT and their impact on world trade is investigated.

Although VERs are in conflict with GATT rules, they are accepted as part of the status quo by most contracting parties. Unless changes in GATT that specifically address the issue of VERs are made, there is no indication that the application of VERs as a protectionist measure will be diminished in the near future.

### ABREGE

Cette thèse est centrée sur le rôle des ententes de restriction volontaire à l'exportation (VERs) dans le commerce international. Introduits comme mesures temporaires de politique commerciale, les VERs existent depuis plus de trente ans. Leur but est de protéger les industries domestiques qui craignent d'être affectées par des importations. La couverture des VERs par le GATT n'est pas encore clairement définie. Les VERs sont appelés des accords de "zone grise" (grey area) et sont généralement utilisés comme mesures de sauvegarde bilatérales. Aujourd'hui près de 10 pour cent du commerce mondial est affecté par des VERs.

A titre d'exemple dans cette étude, l'influence des VERs sur le commerce canadien sera examinée, notamment leur comptabilité avec le système du GATT et leur impact sur le commerce international.

Malgré le fait que les VERs entrent en conflit avec les règles formelles du GATT, ils sont acceptés comme faisant partie du status quo entre les parties contractantes. Bien que des changements au sein du GATT s'opèrent vis-à-vis du problème spécifique des VERs, rien n'indique que l'utilisation des VERs comme mesure protectionniste diminuera dans l'avenir proche.

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## **PREFACE**

The purpose of this thesis is to investigate the role of voluntary export restraint agreements in world trade. While the focus lies on their impact on Canadian trade, it is necessary to consider world trade in general. Limiting the scope of the study to Canada would not give an objective overview of their influence on world trade.

Whenever appropriate, the role of voluntary export restraint agreements in Canadian trade is used as example. There are, however, many aspects of VERs; this requires investigation of their use by other countries, especially by the United States.

## INTRODUCTION

At the end of World War II, international trade was subject to restrictions by tariffs and other protectionist instruments. During multilateral trade negotiations in Geneva in 1947, several states engaged in drafting a Charter for an International Trade Organization (ITO).<sup>1</sup> The Charter was presented the same year at the United Nations Conference on Trade and Employment in Havana. In March 1948, when the Havana Conference ended, the Charter was completed. Meanwhile, on October 30, 1947, twenty-three states signed the General Agreement on Tariffs and Trade (GATT).<sup>2</sup> It was intended as an interim agreement, to be effective until the coming into effect of the Havana Charter.<sup>3</sup> Yet, the Charter was never ratified, and the ITO never established.<sup>4</sup>

GATT entered into force on January 1, 1948.<sup>5</sup> The number of contracting parties has grown since and in June

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<sup>1</sup> Clair Wilcox, *A Charter for World Trade* (New York: Macmillan, 1949).

<sup>2</sup> 55 U.N.T.S. 188, 194. The complete text of the General Agreement as in force since March 1, 1969 is reprinted in GATT, *Basic Instruments and Selected Documents* (B.I.S.D.) Vol.IV (Geneva: GATT Secretariat, March 1969).

<sup>3</sup> Frank Stone, *Canada, the GATT and the International Trade System* (Montreal: Institute for Research on Public Policy, 1987) at 18.

<sup>4</sup> The U.S. Congress refused to approve the Charter. See William Diebold, Jr., *The End of the ITO* (Princeton, N.J.: Princeton University Press, 1952).

<sup>5</sup> By the Protocol of Provisional Application (55 U.N.T.S. 308) reproduced in GATT, B.I.S.D. Vol.IV (Geneva: GATT Secretariat, March 1969) at 77-78.

1988, ninety-six countries were members of GATT.<sup>6</sup> Designed as a temporary agreement, GATT is today the only general multilateral treaty that lays down rules for international trade. GATT's principal purpose is to enlarge the trade relations between nations, to reduce trade barriers and to eliminate any discriminatory treatment in international trade.<sup>7</sup>

GATT is not only a written document, but also a forum for international commercial negotiations and dispute settlement.<sup>8</sup> So far, seven successive "rounds" of multilateral tariff negotiations have taken place under its auspices. The present eighth GATT round began in Punta del Este, Uruguay, in 1986.<sup>9</sup>

The Uruguay Round, and the preceding Tokyo Round (1973-1979), were different from previous GATT trade negotiations, which were primarily concerned with tariffs. Their attention was directed towards the reduction of non-tariff barriers (NTBs).

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<sup>6</sup> Further 28 countries apply GATT rules on a de facto basis see GATT, *What It Is, What It Does* (Geneva: GATT Secretariat, 1988) at 20. The Soviet Union, China, East-Germany, Venezuela and most of the Middle Eastern countries are not members of GATT.

<sup>7</sup> See Preamble of GATT.

<sup>8</sup> At the time GATT was drafted it was considered more a "contract" than an organization, because the ITO was supposed to provide the organizational and secretarial support for GATT, see John H. Jackson, *World Trade and the Law of GATT* [:] *A Legal Analysis of the General Agreement on Tariffs and Trade* (New York: Bobbs-Merrill Company, 1969) at 49.

<sup>9</sup> See GATT, Ministerial Declaration on the Uruguay Round, September 20, 1986, reproduced in GATT, B.I.S.D. 33d Supplement (Geneva: The Contracting Parties, June 1987).

NTBs include export subsidies and countervailing duties, technical barriers to trade, government procurement, anti-dumping duties, import licensing systems, voluntary export restraint agreements and other forms of protectionism which are not tariffs.<sup>10</sup> The diversity of measures makes it impossible to quantify the impact of NTBs on world trade.<sup>11</sup> It is assumed, however, that their effects on international trade today surpass those of tariffs.<sup>12</sup>

At the Kennedy Round (1964-1967), GATT member states were aware of a growth of these instruments.<sup>13</sup> NTBs increased with the progressive reduction of tariffs in GATT.<sup>14</sup> When the Tokyo Round was launched, NTBs represented

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<sup>10</sup> In the Tokyo Round, thirty-three categories of NTBs were listed under the following headings: Government Participation in Trade; Customs and Administrative Entry Procedures; Standards Applicable to Imports and domestic Products; Specific Limitations on Imports and Exports; and Limitations on Imports and Exports through Price Mechanisms, see GATT, *The Tokyo Round of Multilateral Trade Negotiations* (Geneva: Report by the Director-General of GATT, April 1979) at 50 [hereinafter GATT, *The Tokyo Round*]. An UNCTAD list of NTBs distinguishes thirty-eight categories classified in type I: Commercial-Policy Measures; type II: Measures not related Directly Related to Commercial-Policy Questions, but Employed for Trade-Restrictive Ends; and type III: Measures Consistently Applied Without Trade-Distorting Intent, UNCTAD, "Liberalization of Tariffs and Non-Tariff Barriers," TD/B/C.2/R.1, Annex I (Geneva, 1969).

<sup>11</sup> GATT, *The Tokyo Round*, supra, note 10 at 50.

<sup>12</sup> Martin Wolf, "Fiddling While the GATT Burns" (1986) 9 *The World Economy* 1 at 6.

<sup>13</sup> Fred Lazar, *The New Protectionism: Non-Tariff Barriers and Their Effects on Canada* (Toronto: James Lorimer & Company in association with the Canadian Institute for Economic Policy, 1981) at 4.

<sup>14</sup> Edmund Dell, "Off Free Trade and Reciprocity" (1986) 9 *The World Economy* 125 at 129-130.

the most widely used protectionist measures by the member states.<sup>15</sup>

Voluntary export restraint agreements (hereinafter VERs) are one form of NTBs. Significant for this trade measure is the commitment of the exporting country's government or industry to exporting a product only in certain limited quantities in order to give the domestic industry in the importing country relief from the competitive product.<sup>16</sup> VERs have multiplied over the past 30 years, today covering a wide variety of products.<sup>17</sup> Trade sectors which have been most affected are textiles and clothing, steel, automobiles, shipbuilding and consumer electronics.<sup>18</sup>

It is argued that VERs have the most disturbing effects on world trade.<sup>19</sup> However, there is no satisfactory way to measure the extent or degree of trade restrictions.<sup>20</sup> The

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<sup>15</sup> UNCTAD, Report by the UNCTAD Secretariat before the Trade and Development Board (Committee on Manufacture) TD/B/C.2/194 from March 21, 1978 at 2 [hereinafter UNCTAD].

<sup>16</sup> Reinhard Quick, *Exportselbstbeschränkungsabkommen und Artikel XIX GATT* (Köln: Carl Heymanns Verlag, 1983) at 1.

<sup>17</sup> Jan Tumlrir, *Protectionism : Trade Policy in Democratic Societies* (Washington D.C.: American Enterprise Institute for Public Policy, 1985) at 39 [hereinafter Jan Tumlrir, *Protectionism*]

<sup>18</sup> GATT, *Review of Development in the Trading System* (Geneva: GATT Secretariat, 1987) at 99 ff.

<sup>19</sup> Frank Stone, *supra*, note 3 at 204.

<sup>20</sup> Richard Blackhurst, Nicolas Marian & Jan Tumlrir, *Trade Liberalization Protectionism and Interdependence* (Geneva: GATT Study No.5, 1977) at 44.

majority of VERs are not made public.<sup>21</sup> Their total number is unknown. No reliable statistics are available to assess the quantity of world trade affected.<sup>22</sup>

A GATT study of international trade estimates that approximately three to five percent of international exchanged goods are subject to VERs.<sup>23</sup> This number is considered to be too low by others.<sup>24</sup> In his recent analysis, Michel Kostecki comes to the conclusion that VERs control ten percent of the world market.<sup>25</sup> For the period between 1986 and 1987, he lists 137 VERs.<sup>26</sup> About 68 of them are concluded to protect the market of the European Communities, 45 to protect the market of the United States and 10 to protect the Canadian market.

Among the 137 VERs listed by Michel Kostecki, 44 agreements affect steel and steel products, 25 textile and clothing products, 9 automobiles, 18 footwear, 25 agricultural products and 6 machine tools. Canada

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<sup>21</sup> John Black and Brian Hindley, eds., *Current Issues in Commercial Policy and Diplomacy: Papers of the Third Annual Conference of the International Economic Study Group* (London: Macmillan for the Trade Policy Research Center, 1980) at 52.

<sup>22</sup> Victoria Curzon Price, "Surplus Capacity and What the Tokyo Round Failed to Settle" (1979) 2 *The World Economy* at 310.

<sup>23</sup> Richard Blackhurst, Nicolas Marian & Jan Tumlr, *supra*, note 20 at 44 (footnote 69).

<sup>24</sup> Brian Hindley, "Voluntary Export Restraints and the GATT's Main Escape Clause" (1980) 3 *The World Economy* at 316. Brian Hindley does not give an estimate himself.

<sup>25</sup> Michel Kostecki, "Export-Restraint Arrangements and Trade Liberalization" (1987) 10 *The World Economy* at 429.

<sup>26</sup> *Ibid.*, table 4 pp. 442-450. This list is incomplete due to all the unpublished VERs.

negotiated four VERs for textile and clothing products imported from North Korea, Maldives, Pakistan and Vietnam. Furthermore, it negotiated two agreements on automobiles and four agreements on footwear.<sup>27</sup>

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<sup>27</sup> Based on: Canada, *Summary of Canada's Bilateral Restraint Arrangements - Textiles and Clothing* (Ottawa, External Affairs, October 1987) at 1 [hereinafter Canada, *Textiles and Clothing*]. Canada negotiated VERs of textiles and clothing with 22 exporting countries. Canada's government did not agree on VERs on footwear. In this trade sector, imports are regulated by global quotas.

## 1. CHAPTER: SCRUTINY OF VER AGREEMENTS

### 1. Development in the 1970's

In the 1960's the world economy experienced an increase in industrial production and in employment. This trend was reversed a decade later. The 1970's were characterized by a worldwide economic recession which led to high inflation rates, a growing number of uncompetitive industries and an increase in unemployment.<sup>28</sup>

The situation of the industrialized states was aggravated by an augmentation of imports from developing countries. Contrary to the stagnation observed in the developed countries, parts of the Third World enjoyed an industrial boom. Mass imports from the so-called "low-cost" countries had serious economic effects on many industries in the United States, European countries and Canada.<sup>29</sup> Low wages allowed industries in developing countries to offer their products at prices below those of similar goods in the importing country.<sup>30</sup> The price competition was particularly noticeable with labor-intensive goods such as textile and clothing, footwear, and consumer electronics.<sup>31</sup>

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<sup>28</sup> Bela Balassa, "The 'New Protectionism' and the International Economy" (1978) 12 *Journal of World Trade Law* 409 at 413-414.

<sup>29</sup> Caroline Pestieau and Jacques Henri, *Non-Tariff Trade Barriers as a Problem in International Development* (Montréal: The Canadian Economic Policy Committee and the Private Planning Association of Canada, 1973) at 11 ff.

<sup>30</sup> *Ibid.* at 79 ff. The low wages are their most important comparative advantage.

<sup>31</sup> *Ibid.*

In addition, many industries in the industrialized countries were in an out-dated condition. They suffered from backward production techniques and low productivity.<sup>32</sup> Adjustment measures needed to be introduced to restructure these industries and make them more competitive. Adjustment policies, however, are difficult to support during an economic depression. The costs which can be absorbed from other industrial sectors in a period of economic welfare are hard to cover in a period of stagnation.<sup>33</sup>

The affected industries in the developed countries called for import protection against foreign competitors, who were accused of being responsible for the disturbance of the national market. The governments were forced to react under the pressure of powerful domestic industries.<sup>34</sup> It was also feared that, due to declining sales, many workers in the affected industries would be laid off. In some countries entire regions were dependant on a particular industrial sector. In Quebec, for example, the textile and clothing industries were major employers in many smaller communities.<sup>35</sup> In order to solve these problems, government officials wished to invoke quantitative restrictions to stop the flow of cheap imports.

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<sup>32</sup> Donald B. Keesing and Martin Wolf, *Textile Quotas against Developing Countries* (London: Trade Policy Research Center, 1980) at 7 describes the underlying influences for the rise of protectionism against the developing countries.

<sup>33</sup> Alasdair MacBean, "How to Repair the 'Safety Net' of the International Trading System" (1978) 1 *The World Economy* at 154.

<sup>34</sup> The United States textile and automobile industries are very powerful industries.

<sup>35</sup> A. J. Sarna, "Safeguards against Market Disruption - A Canadian View" (1976) 10 *Journal of World Trade Law* 355 at 367.

GATT, however, prohibits any member country from imposing quantitative restrictions on imports (Article XI).<sup>36</sup> There are exceptions to the general rule included in GATT. Unilateral import restrictions are permissible for member nations needing to safeguard their external financial position and balance of payments (Article XII), to assure policies of economic development in some member states (Article XVIII), and to protect essential security interests of a country (Article XXI).

Import protection as a response to unforeseen developments in the importing country can be granted under the safeguard clause (Article XIX). The safeguard clause allows a member country to impose import restrictions on products which have been imported in such increased quantities and under such conditions that they cause or threaten to cause serious injury to competing domestic producers.<sup>37</sup> The purpose of the safeguard clause is to give countries affected by mass imports the opportunity to adjust accordingly, without being disturbed by competitive imports.

Article XIX of GATT was considered to be an unfavorable import relief measure by the governments and the domestic industries for mainly two reasons. First, the safeguard clause has to be applied on a non-discriminatory basis, i.e., against all countries supplying a particular product.<sup>38</sup> It does not allow the states to impose import protections on a selective basis.

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<sup>36</sup> Tracy Murray and Ingo Walter, "Quantitative Restrictions, Developing Countries and GATT" (1977) 11 Journal of World Trade Law 391 at 394.

<sup>37</sup> See John H. Jackson, *supra*, note 8 at 556-564: Prerequisites to an Article XIX Escape Clause Action.

<sup>38</sup> Ernst-Ulrich Petersmann, "Economic, Legal and Political Functions of the Principle of Non-Discrimination" (1986) 9 The World Economy at 113-121.

The General Agreement only recognizes discriminatory selective safeguard measures in cases of dumping or subsidization (Article VI), and to conform with obligations under the United Nations Charter for the maintenance of international peace and security (Article XXI). Most of the time, governments do not wish to apply import restrictions against all countries. They may have very old and close trade relations or special agreements with some countries,<sup>39</sup> and they may fear retaliation from other countries.

Second, Article XIX of GATT implies that the safeguarded states have to pay compensation to those countries whose exports have been restricted.<sup>40</sup> If compensation is not an adequate measure, the exporting countries are allowed to retaliate against the trade of the country imposing the protectionist measures. Retaliation may consist of suspending equivalent concessions or other obligations under GATT.<sup>41</sup>

The safeguard clause is inadequate in providing import relief against individual countries whose sudden increases of imports are causing distortions of the market.<sup>42</sup> Therefore GATT member states applied VERs which had already been used before to give import protection to domestic industries.<sup>43</sup>

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<sup>39</sup> Brian Hindley, *supra*, note 24 at 326.

<sup>40</sup> John H. Jackson, *supra*, note 8 at 565-566.

<sup>41</sup> Article XIX (3(a)) of GATT.

<sup>42</sup> Jan Tumliar, "A Revised Safeguard Clause for GATT?" (1973) 7 *Journal of World Trade Law* 404 at 407.

<sup>43</sup> Gary H. Perlow, "The Multilateral Supervision of International Trade: Has the Textiles Experiment Worked?" (1981) 75 *American Journal of International Law* 93 at 95.

## 2. Historical Background

The origin of VERs dates back to the 1930's. In the period between the two World Wars, the United States and Japan negotiated four VERs, covering cotton cloth, floor coverages, hosiery, and velveteen and corduroy products.<sup>44</sup> At that time, international trade was determined by the trade policy of each state.<sup>45</sup> Governments were free to decide whether or not they wanted to restrict foreign products from entering their markets.

In 1948, when GATT entered into force, international trade became regulated. Unilateral actions by the member states were no longer allowed. GATT provisions are only binding between member states. In the trade with non-signatory states, such as Japan, discriminatory measures continued to be employed.<sup>46</sup>

By the beginning of the 1950's, the Japanese economy had become very strong and competitive. Japan's exports, especially textile products to Europe and North America, increased continuously.<sup>47</sup> To avert the flood of Japanese products, countries applied discriminatory trade

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<sup>44</sup> Stanley D. Metzger, "Injury and Market Disruption from Imports" *United States International Economic Policy* (Williams Commission) (Washington: United States Government Printing Office, 1971) Papers I. He indicates that the agreements could only have been reached by American pressure and threats.

<sup>45</sup> Kenneth W. Dam, *The GATT [:] Law and International Economic Organization* (Chicago: University of Chicago Press, 1970) at 15: The International Environment before GATT.

<sup>46</sup> *Ibid.* at 297.

<sup>47</sup> Warren S. Hunsberger, *Japan and the United States in World Trade* (New York, Evanston, 1964) at 421-427.

restrictions on Japanese imports.<sup>48</sup> These unilateral measures were no longer permissible in 1955 when Japan became a signatory to GATT. Instead, VERs were invoked against Japan.<sup>49</sup>

The renaissance of VERs was due to the need for protection of GATT member states from Japanese imports.<sup>50</sup> The first VER was concluded between the United States and Japan in 1956, regarding cotton textiles.<sup>51</sup>

Japan was the first country which could offer textile products at lower prices on American and European markets. It was followed by other, mostly developing countries,<sup>52</sup> which assumed the market shares Japan had given up when agreeing to VERs. The industries in the developed countries were confronted with the inexpensive imports of these countries. Consequently, they also tried to negotiate VERs with these competing countries.

The textile industry was the point of departure for VERs.<sup>53</sup> The textile and clothing industry is of major importance, not only for developed but also for under-developed countries. For many of the world's poorest

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<sup>48</sup> Kenneth W. Dam, *supra*, note 45 at 297.

<sup>49</sup> Gary H. Perlow, *supra*, note 43 at 95.

<sup>50</sup> See Gardner Patterson, *Discrimination in International Trade : The Policy Issues 1945-1965* (Princeton: Princeton University Press, 1966) at 293-300 for further details.

<sup>51</sup> *Ibid.* at 297. GATT, Doc. L/1164 from May 17, 1960 at 12.

<sup>52</sup> For example Hong Kong, Pakistan and India, see Kenneth W. Dam, *supra*, note 45 at 300.

<sup>53</sup> Malcolm Smith, "Voluntary Export Quotas and U.S. Trade Policy - A New Non-tariff Barrier" (1973) 5 *Law and Policy in International Business* 10 at 12 (footnote 8).

nations, the textile and clothing industry is a major step towards development.<sup>54</sup>

After the Second World War, the textile and clothing industries in the industrialized countries resumed pre-World War II levels of production, whereas Third World production in these industries increased enormously. At the end of the 1950's, a multitude of VERs had been concluded in the textile sector, mostly between industrialized and less developed countries. It became obvious to many nations that world trade problems in textiles and clothing could only be solved on a multilateral basis.

In 1961, the American textile industry, severely affected by an increase in imports, induced the Kennedy Administration to get multilateral trade negotiations in this field under way.<sup>55</sup> This resulted in the formation of the "Short Term Arrangement Regarding International Trade in Cotton Textiles" (STA).<sup>56</sup> It was renewed and renamed the "Long Term Agreement on Cotton Textiles" (LTA) in 1962.<sup>57</sup>

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<sup>54</sup> A. J. Sarna, *supra*, note 35 at 366.

<sup>55</sup> Frank Stone, *supra*, note 3 at 103; Gardner Patterson, *supra*, note 50 at 307-310.

<sup>56</sup> GATT, Basic Instruments and Selected Documents (B.I.S.D.) 10th Supplement (1962) at 18-23. It was in force from October 1, 1961 to September 31, 1962.

<sup>57</sup> Long Term Arrangement Regarding International Trade in Cotton Textiles, GATT, B.I.S.D. 11th Supplement (1963) at 25-41. See Benyamin Bardan, "The Cotton Textile Agreement 1962-1972" (1973) 7 *Journal of World Trade Law* 8 ff.

The LTA was in force from 1962 to 1972.<sup>58</sup> During that time, Canada negotiated VERs with 30 countries. In 1972, cotton textiles were no longer the only source of problems for the textile industry. Besides cotton products, other fibres, machine-made fibres became more important.<sup>59</sup> The LTA was replaced by the "Arrangement Regarding International Trade in Textiles", known as the Multi-Fibre-Agreement.<sup>60</sup> It came into effect in 1974. It has been extended repeatedly. On July 31, 1986, the MFA IV was signed for a further period of five years until July 31, 1991.<sup>61</sup>

### 3. Nature of VER Agreements

VERs are bilateral agreements between two countries or industries. The exporting side agrees to restrain its exports to the importing country at a stipulated level and for a determined period of time.<sup>62</sup> VERs are often referred to as a "new type" of NTBs<sup>63</sup> or "grey area" measure.<sup>64</sup> The descriptions are due to the peculiar nature of these

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<sup>58</sup> Ibid. The LTA was agreed to for five years until 1967 and extended twice afterwards for three years, GATT, B.I.S.D. 15th Supplement (1968) at 56.

<sup>59</sup> A. J. Sarna, *supra*, note 35 at 359;

<sup>60</sup> GATT, B.I.S.D. 21th Supplement (1975) at 3 ff.

<sup>61</sup> By Protocol Extending the Arrangement Regarding International Trade in Textiles, GATT, B.I.S.D. 33d Supplement (Geneva: The Contracting Parties, 1987) at 7-14.

<sup>62</sup> Peter Wong, "The Japanese Automotive Voluntary Export Restraint Agreements and International Law" (1985) 23 Canadian Yearbook of International Law at 300.

<sup>63</sup> Reinhard Quick, *supra*, note 16 at 1;

<sup>64</sup> Michel Kostecki, *supra*, note 25 at p.426;

measures, which differ from other barriers to trade in several ways.<sup>65</sup> This is outlined in the next paragraphs.

#### a. Characteristics

The main characteristic of VERs is the renunciation by the exporting country or industry to exploit its existing export capacities for the benefit of the importing country.<sup>66</sup> The importing nation does not have to impose unilateral legislative or safeguard measures to restrict competitive foreign products. The restriction takes place in the exporting country.

The government of the exporting country has to ensure that its industries keep the exports of restricted products within the agreed quota level. Thus, government intervention in the market increases with VERs.<sup>67</sup>

Another phenomenon accompanying VERs is the establishment of export cartels in the restrained country.<sup>68</sup> The execution of a VER is only guaranteed if the exporting side has the power to control the level of exports.<sup>69</sup> Accordingly, if neither a monopoly, nor a cartel already

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<sup>65</sup> UNCTAD, *supra*, note 15 at 6.

<sup>66</sup> Reinhard Quick, *supra*, note 16 at 1.

<sup>67</sup> Martin Wolf, *supra*, note 12 at 8.

<sup>68</sup> OECD, *Competition and Trade and Policies, Their Interaction* (Paris: OECD, 1984) at 491.

<sup>69</sup> Misao Tatsuta, "Voluntary Export Restraints - Implementation and Implications" (1985) 49 *Rabels Zeitschrift* 328 at 333.

exists, the exporting industry will have to form a cartel as a precondition for a successful VER.<sup>70</sup>

VERs are used against labor-intensive and low-priced goods which injure industries with higher manufacturing costs in industrial states. The inexpensive products are exported by less developed or socialist nations. These countries are therefore the main targets of VERs.<sup>71</sup> It is notable, however, that VERs are used as well to protect industrialized states' markets such as the United States or Canada against imports from the European Communities or Japan.<sup>72</sup>

Most VERs are negotiated in secrecy between the two nations concerned.<sup>73</sup> The secrecy of VERs injures third parties because they are often not given the opportunity to participate in the negotiations.<sup>74</sup> In Japan for example, the government agreed on a VER on an industrial product without giving the bewildered exporting industry a hearing on this subject.<sup>75</sup> VERs lack the transparency of other

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<sup>70</sup> Orr, "International Quantitative Restrictions on World Textile Trade" (1980) 38 University of Toronto Faculty Law Review 52 at 67; C. Fred Bergsten, ed., *On the Non-Equivalence of Import Quotas and Voluntary Export Restraints: Towards a New World Trade Policy: The Maidenhead Papers* (Lexington: D.C. Heath and Company, 1975)

<sup>71</sup> UNCTAD, *supra*, note 15 at 5.

<sup>72</sup> The steel arrangement between the United States and the European Communities, in force since October 21, 1982, OJL 307 (1982) at 12. It was extended in November 1985 for four years, by the Arrangement Extending and Modifying the Arrangement of October 21, 1982 concerning steel products, OJL 355 (1985) at 2.

<sup>73</sup> Reinhard Quick, *supra*, note 16 at 279.

<sup>74</sup> Misao Tatsuta, *supra*, note 69 at 334-335.

<sup>75</sup> Malcolm Smith, *supra*, note 53 at 54 (footnote 189).

trade restrictions such as tariffs, anti-dumping duty or countervailing duty tribunals.<sup>76</sup>

#### b. Different Types of Agreements and their Legal Nature

VERs can be found in different types of agreements and arrangements.<sup>77</sup> They can be formulated on an industry-to-industry level between the exporting industry in one country and the troubled domestic industry in the importing country. The industry's interest in the importing country can also be represented by their government; the negotiations may then lead to a VER between the government and the exporting industry. Finally, VERs can take the form of an arrangement or agreement between two governments.

##### 1) Industry-to-Industry Agreements

Negotiations on VERs can be held between two industries producing the same or similar products in different countries at different prices. The disadvantaged industry will seek to have its counterpart restrict exports of the same or similar products. Two of the first VERs in the 1930's between Japan and the United States were arranged on an industrial level.<sup>78</sup> The representatives of the industries of both states negotiated and signed an agreement in which Japan agreed to restrict its exports on cotton products to the United States.

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<sup>76</sup> Edmund Dell, *supra*, note 14 at 131.

<sup>77</sup> Reinhard Quick, *supra*, note 16 at 45; Malcolm Smith, *supra*, note 53 at 16-22;

<sup>78</sup> Reinhard Quick, *supra*, note 16 at 45.

A VER between two industries will only be effective if all exporters of a respective good take part. Therefore the exporting industry either has to be a monopoly or all producers must be joined in a cartel.<sup>79</sup>

VERs between two industries are problematic because they may contravene antitrust laws.<sup>80</sup> In Japan, the Fair Trade Commission prohibited Japanese industries from entering into such agreements because they violated Article six of Japanese law, concerning prohibition of private monopoly and methods of preserving fair trade (Anti-monopoly Law).<sup>81</sup>

Industry-to-industry agreements are not negotiated often. Industries are concerned about violations of antitrust laws, and therefore prefer to have their interests represented by their governments.<sup>82</sup>

## 2) Government-to-Industry Agreements

VERs between governments of importing nations on one side and the exporting industries on the other are rare. The only agreement existing in this form is a VER between the United States and Japanese steel companies, represented

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<sup>79</sup> Malcolm Smith, *supra*, note 53 at 16.

<sup>80</sup> Donald E. de Kieffer, "Antitrust and the Japanese Auto Quotas" (1982) 50 Antitrust Law Journal 779; Robert J. Leo, "An Update of the Japanese Automobile Export Restraint" (1982) 8 Brooklyn Journal of International Law 58 ff.

<sup>81</sup> Law No. 54 from April 14, 1947 (English translation in EHS vol.2, KA No. 2270).

<sup>82</sup> Malcolm Smith, *supra*, note 53 at 17 (footnote 21).

by the Japan Iron and Steel Exporters Association.<sup>83</sup> In 1969, Japanese steel industries agreed to reduce their exports to the United States by 77 percent compared to the level of 1968. The agreement collapsed in 1971, but was renewed in 1972 for two years.<sup>84</sup>

Government agreements with foreign industries are weakened when the exporting side does not keep the export quota at the stipulated level. The government has no legal ability to enforce the VER against the exporting industries.<sup>85</sup> The agreement of the exporting industry to reduce its exports is a unilateral promise rather than a bilateral agreement.<sup>86</sup> The agreement is not binding.<sup>87</sup>

### 3) Government-to-Government Agreements

VERs are most often concluded between two governments. However, it is difficult to gauge whether they are legally binding or non-binding agreements, formal or informal agreements. Government-to-government agreements can be divided in two groups:

The first group includes agreements, which have been formulated into official documents wherein the exporting state agrees to restrain its exports at a stipulated level and for a certain period of time. The importing country

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<sup>83</sup> Michael S. Bates, "The Voluntary Quota System for Regulating Steel Imports" (1973/1974) 14 Virginia Journal of International Law 101 at 105.

<sup>84</sup> Ibid. at 108 and 111-112.

<sup>85</sup> Reinhard Quick, *supra*, note 16 at 51.

<sup>86</sup> Malcolm Smith, *supra*, note 53 at 19 (footnote 31).

<sup>87</sup> Reinhard Quick, *supra*, note 16 at 51.

agrees not to take any legislative measure or safeguard action (Article XIX of GATT). Examples of such government-to-government VERs are the textile and clothing agreements. They constitute legally binding, formal treaties.

The second group contains all agreements which have been reached secretly and where no official document is published. The negotiations proceed with an exchange of letters from government representatives in the importing state to their counterparts in the exporting state.<sup>88</sup> The importing side will therein explain the difficulties caused by increased imports situation for the domestic industry, and suggest a VER as a favorable measure for the trade relations between both countries. Warnings and threats of legislative measures may be included in these negotiations.<sup>89</sup>

In reply, the exporting country may express its desire for a close cooperation between the two states, and may accordingly decide to restrain their exports of the relevant good at the proposed or higher level. The importing country in return will welcome the VER as the voluntary, unilateral decision of the other side. These agreements are called "gentlemen's agreements."

For the import state, the restraint measure is a unilateral action on the exporting side.<sup>90</sup> The term

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<sup>88</sup> For example, see letters from the ambassador of Japan, Yoshio Okawara, and the reply from Attorney General William French Smith, May 1981, relating to a VER in passenger cars of Japan to the United States in: D. E. de Kieffer, *supra*, note 80 at 787-789.

<sup>89</sup> Edmond McGovern, *International Trade Regulation: GATT, The United States and The European Community* (Exeter: Globefield Press, 1986) at 297.

<sup>90</sup> Misao Tatsuta, *supra*, note 69 at 333.

unilateral in this respect is not to be considered a legal term.<sup>91</sup> In public international law, the question as to whether or not an agreement is binding for both sides depends on the intention of the parties in formalizing the agreement. Since both sides have an interest in a VER, the so-called "gentlemen's understandings" are formal and binding agreements.<sup>92</sup>

### c. Administration and Control

#### 1) Exporting Side

Responsibility for the administration and control of the negotiated quota rests with the exporting country.<sup>93</sup> Therefore, the burden of applying import controls is eliminated for the importing country. The exporting countries usually control the export quota through a licensing system among their manufacturers.<sup>94</sup>

For example, in Japan, the Ministry of International Trade and Industry (MITI) is responsible for the administration of export controls.<sup>95</sup> Each exporter has to obtain an export license before he is allowed to ship goods restrained under a VER.<sup>96</sup> The distribution of licenses is

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<sup>91</sup> Michel Kostecki, *supra*, note 25 at 426.

<sup>92</sup> Reinhard Quick, *supra*, note 16 at 57.

<sup>93</sup> Michel Kostecki, *supra*, note 25 at 427.

<sup>94</sup> A. J. Sarna, *supra*, note 35 at 364.

<sup>95</sup> Mitsuo Matsushita, "Export Control and Export Cartels in Japan" (1979) 20 *Harvard International Law Journal* 103

<sup>96</sup> Article 48 of the Foreign Exchange and Foreign Trade Control Law, Law No.228 from December 1, 1949 (English translation in EHS Vol.5 AA No.5010).

set by MITI according to the export share of each exporter in the previous year.<sup>97</sup> To control the exports of automobiles, each manufacturer in Japan has to submit a monthly report on its exports to MITI. If the automobile companies fail to file their reports or file false reports, the export of cars would become subject to an export licensing system by the Japanese government.<sup>98</sup>

## 2) Importing Side

To ensure that the exporting country does not exceed the agreed quantity of products, the import country will verify the imports of restricted goods. In Canada, which is chosen as an example, the administration and control of VERs is the same as for unilateral import quotas. The Export and Import Permits Act is the relevant legal basis for both.

Under section 5 (2) of the Export and Import Permits Act, all products subject to a VER are registered on the Import Control List.<sup>99</sup> Products included in the Import Control List are required to have an import permit, called "B3".<sup>100</sup> Each importer who wishes to sell a VER restrained product on the Canadian market has to apply for a B3. The Export and Import Permits Division of the Department of

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<sup>97</sup> Mitsuo Matsushita and Lawrence Repeta, "Restricting the Supply of Japanese Automobiles: Sovereign Compulsion or Sovereign Collusion?" (1982) 14 Case Western Report Journal on International Law 47 at 53 and 68: Administrative Guidance by MITI.

<sup>98</sup> Donald E. de Kieffer, *supra*, note 80 at 787.

<sup>99</sup> Export and Import Permits Act, R.S. c.E-17; c.32 (2nd Supplement); 1984, c.25, s.104 as amended by Canadian International Trade Tribunal Act, S.C. 1988 c.56.

<sup>100</sup> "B3" is the Import Entry Coding Form which has to be filled out by every importer, and which has to be approved by Canada Customs.

External Affairs is the authority appropriated to issue, amend, suspend, cancel or reinstate import permits. Without a B3, products are not allowed to enter Canada. All Import Permits are administered at the border by customs officers.

Each permit application must further be accompanied by the original copy of a special export document issued by the appropriate authority in the country of origin of the goods, indicating that the shipment has been charged against the corresponding restrained level.<sup>101</sup> This ensures for Canadian authorities that there has been no overshipment or re-export through third countries.<sup>102</sup>

All B3 import permits are collected and sent to Statistics Canada, which checks to see that the negotiated quota has not already been exhausted. If a country increases its imports or has nearly reached the quota, the Canadian government notifies the exporting country. A monthly exchange of statistics between Canada and the exporting country concerning the number of exported and imported products ensures that both countries are aware of levels.

#### d. Economic Effects

The protected industries in the importing country, and their workers, are the beneficiaries of a VER, while the exporter is the apparent victim. Through the reduction of exports he loses profits he could have gained under normal market conditions. However, as is shown below, the exporting side does not necessarily have to suffer losses under a VER.

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<sup>101</sup> Canada, *Textiles and Clothing*, supra, note 27 at 2.

<sup>102</sup> A. J. Sarna, supra, note 35 at 364.

The importing country also harms itself, as it has to bear the great economic costs produced by VERs. Yet the real loser is the consumer in the importing country.<sup>103</sup> Through higher prices he will have to pay the costs for each job saved in his country's industry.

#### 1) Exporting Country

VERs require the exporting country to limit its exports in favour of the importing country.<sup>104</sup> It gives up export capacities it could otherwise have used. The exporter loses possible income. Whenever possible, the exporter will compensate for the reduction in quantity by an increase in prices of the exported goods.<sup>105</sup> The rise in profitability per unit compensates the exporters for the imposed restrictions in volume.<sup>106</sup> Under a VER the exporting industry may actually achieve higher profits than it would have obtained without restriction.<sup>107</sup>

In the automobile trade, for example, the restrained industry may shift from a low value to a high value category of products.<sup>108</sup> VERs in this trade sector only limit the

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<sup>103</sup> Michel Kostecki, *supra*, note 25 at 434 and Table 2 at 435.

<sup>104</sup> UNCTAD, *supra*, note 15 at 5.

<sup>105</sup> Ernst-Ulrich Petersmann, "Grey Area Trade Policy and the Rule of Law" (1988) 22 *Journal of World Trade Law* 23 at 27; Gerard and Victoria Curzon, "Defusing Conflict between Traders and Non-Traders" (1986) 9 *The World Economy* 19 at 23.

<sup>106</sup> Martin Wolf, *supra*, note 12 at 8.

<sup>107</sup> Brian Hindley in Black and Hindley, *supra*, note 21 at 55. He undertakes an economic analysis of VERs.

<sup>108</sup> Michel Kostecki, *supra*, note 25 at 427.

volume of exports. They do not refer to a special type or value of automobile. A restrained Japanese car manufacturer may change to other types of automobiles. Instead of exporting small and inexpensive cars, for example, he will deliver medium sized or luxurious cars.<sup>109</sup>

Small cars have a very narrow price range. The possible profit range becomes greater with larger and more expensive cars. The higher prices of these cars may outweigh the quantity limitation and result in greater profits than before.<sup>110</sup> The exporting industry can achieve the same profit margin it would have achieved without restricted exports.<sup>111</sup>

In the textile sector, exporters try to maximize their profits by supplying the most valuable products within each quota category.<sup>112</sup> For example, if one textile and apparel category includes women's and girls', children's and infants' dresses, the restrained manufacturer will only export women's dresses. They are the products with the highest value in this category. Consequently, girls, children and infants will not be supplied. Domestic prices of these dresses will increase even more than if imports, even restricted, continued to flow.<sup>113</sup>

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<sup>109</sup> Misao Tatsuta, *supra*, note 69 at 344.

<sup>110</sup> Robert J. Leo, *supra*, note 80 at 172.

<sup>111</sup> Taking competition in the exporting country and other factors into account, Mitsuo Matsushita and Lawrence Repeta, *supra*, note 97 at 52 (footnote 18) doubt that the reduced export quantity can result in increased profits.

<sup>112</sup> Tracy Murray and Ingo Walter, *supra*, note 36 at 410.

<sup>113</sup> *Ibid.*

The formation of a cartel among the restricted exporting industries especially benefits large and established firms.<sup>114</sup> The quota or licensing system used by governments to distribute the export shares is based on previous export performances. This is of advantage for bigger firms but of disadvantage for new and smaller companies. The export gains go to the established industries, which will take over price leadership for the product.<sup>115</sup> They often sell quota shares in the open market to smaller companies. Markets for quota shares thus build up in the exporting countries.

## 2) Importing Country

Export restrictions on foreign competitors give the domestic industry a chance to get back market shares it had lost and would not have gained back under normal competition.<sup>116</sup> The purpose of VERs is that industries which are no longer competitive can be rescued and adapted to new circumstances.<sup>117</sup>

VERs are also intended to protect jobs that would be otherwise lost to competition from imports.<sup>118</sup> It is questionable whether they really do so. The fact that a major exporter has been restricted through a VER does not necessarily bring improvement to the domestic industry.

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<sup>114</sup> Richard Blackhurst, Nicolas Marian & Jan Tumlr, *supra*, note 20 at 56.

<sup>115</sup> Jan Tumlr, *Protectionism*, *supra*, note 17 at 40.

<sup>116</sup> Misao Tatsuta, *supra*, note 69 at 343.

<sup>117</sup> UNCTAD, *supra*, note 15 at 8.

<sup>118</sup> William R. Cline, *The Future of World Trade in Textiles and Apparels* (Washington, D.C.: Institute for International Economics, 1987) at 187.

Third countries, whose suppliers have not been restricted will increase their imports to extend their market shares.<sup>119</sup> Exactly this took place on the Canadian automobile market. After Japan declared in 1981 that it would restrain its automobile shipments to Canada, South Korean cars appeared on the Canadian market. Its exporters quickly won the market shares Japan had given up.

VERs may prevent unemployment for a short period of time.<sup>120</sup> As the example shows, VERs do not necessarily guarantee a certain market share for a long period of time, and therefore the job assurance of protected industries is only of short duration. The short-term effects of VERs do not outweigh the economic costs for the entire economy.

David Greenaway and Brian Hindley from the Trade Policy Research Center of Great Britain published a study estimating the net costs of VERs to the United Kingdom in four different industrial sectors: cars, videos, recorders and textiles.<sup>121</sup> According to their study, each job saved or created in the video recorder industry cost Britain 80,000 Pounds. At that price, the government could abandon VERs, pay a significant amount of money to those workers who lost their jobs and at the same time reduce costs for the rest of the population.<sup>122</sup>

VERs produce great economic costs. Costs imposed on the economy by tariffs are lower than those imposed by VERs. David Greenaway and Brian Hindley come to the conclusion

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<sup>119</sup> Misao Tatsuta, *supra*, note 69 at 344.

<sup>120</sup> William R. Cline, *supra*, note 118 at 187.

<sup>121</sup> David Greenaway and Brian Hindley, *What Britain Pays for Voluntary Export Restraints* (London: Trade Policy Research Center, 1985).

<sup>122</sup> *Ibid.* at 16.

that Japanese VERs on cars cost Britain a minimum of 180 million Pounds a year, equivalent of a subsidy of 1,895 Pounds for each extra British car produced.<sup>123</sup>

A study published by the United States Federal Trade Commission gives further examples relating to costs caused by VERs in the United States.<sup>124</sup> The American economy suffered, for example, some \$994 million in efficiency and other losses annually as a result of VERs with Japan on automobiles. According to this study, the benefits obtained by Japan amount to \$824 million compared to \$115 million of U.S. production gains.<sup>125</sup>

VERs are considered to be the most costly form of protection.<sup>126</sup> A comparison of the effects of a tariff and a VER for the economy of the importing country shows the following: While tariffs transfer income from the consumer to the government which collects the higher price, a VER transfers money spent by consumers to foreign producers.<sup>127</sup> The revenue transferred to the exporting country is also categorized by economists as a "quota rent."<sup>128</sup> Kostecki

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<sup>123</sup> *Ibid.* at 85.

<sup>124</sup> David G. Tarr and Morris E. Morke, "Aggregate Costs to the United States of Tariffs and Quotas on Imports: General Tariff Cuts and Removal of Quotas on Automobiles, Steel, Sugar and Textiles" (1984) Bureau of Economics Staff Report to the Federal Trade Commission.

<sup>125</sup> *Ibid.*

<sup>126</sup> Ernst-Ulrich Petersmann, *supra*, note 105 at 30.

<sup>127</sup> Tracy Murray and Ingo Walter, *supra*, note 36 at 400.

<sup>128</sup> Ernst-Ulrich Petersmann, *supra*, note at 27 also calls them "protection rents" or "scarcity rents" at 30.

estimates that the world quota rent resulting from VERs is approximately \$27 billion a year.<sup>129</sup>

Canada changed to a buyers quota basis, in order to prevent quota rents from going to the exporter. Every good restricted by a VER is put on the import control list. Licenses are issued to importers of the product.<sup>130</sup> Without an import license no exported products are allowed to enter Canada. This way, profits will accrue to importers. The import quota system has created a quota market in Canada. Every day in national newspapers, quotas are offered and sought.

Finally, VERs have long term implications for other industries and trade sectors in the importing country. By limiting exports of one country, the income and the demand for products in the importing country will decline, thereby reducing exports of the importing country. No country can enjoy exporting to other countries without accepting their imports in return.<sup>131</sup> Saving jobs in uncompetitive industries simultaneously discourages the creation of jobs in industries with a future.<sup>132</sup>

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<sup>129</sup> Michel Kostecki, *supra*, note 25 at 432.

<sup>130</sup> See under c) Administration and Control

<sup>131</sup> Victoria Curzon Price, *supra*, note 22.

<sup>132</sup> Oliver Long, *Law and its Limitations in the GATT Multilateral Trade System* (Dordrecht: Martin Nijhoff, 1985) at 253.

### 3) Consumers in the Importing Country

From the consumer's point of view, a VER has the same effect as a tariff: it increases prices.<sup>133</sup> The same products are more expensive after the introduction of a VER than before. The rise in prices produces a reduction of real income for the consumer, because he has less money left to purchase other goods. Restrained products are no longer available to all consumers due to their reduced number.<sup>134</sup> The choice among different brands is limited to the remaining, more expensive ones. Lower income consumers therefore feel the effects of VERs most.<sup>135</sup> They are deprived of the opportunity to buy products at a lower price.

The Japanese VER on passenger cars resulted in a cost of \$1.1 billion in higher prices to the American consumer every year it was in force.<sup>136</sup> The VERs on steel products exported to the United States since 1983 cost the consumer in the United States \$1,131 million annually.<sup>137</sup> Each job saved by the United States steel quota produces annual costs of \$113,622 to the consumer. Over the five years that these VERs were in force, they resulted in a \$5 billion cost to the consumer, compared to \$143 million in worker earning losses which were saved.<sup>138</sup>

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<sup>133</sup> Brian Hindley, *supra*, note 24 at 328.

<sup>134</sup> Misao Tatsuta, *supra*, note 69 at 343.

<sup>135</sup> Richard Blackhurst, Nicolas Marian & Jan Tumlrir, *supra*, note 20 at 54.

<sup>136</sup> David G. Tarr and Morris E. Morke, *supra*, note 124.

<sup>137</sup> In 1983 the United States government concluded VERs with Japan, South Korea, Spain, Brazil, South Africa, Mexico, Australia and the EEC to limit steel imports at 18.5 percent of domestic consumption, *ibid*.

<sup>138</sup> *Ibid*.

### e. Reasons for the Creation of New VER Agreements

Once introduced in a certain trade field, one VER gives rise to others.<sup>139</sup> There are primarily two situations which lead to negotiations of new VERs. In the first, a competitive product which had been restricted by a VER is replaced by another foreign product on the market at the same low price.<sup>140</sup> The new competitor takes over the market share the domestic industry claimed for itself. The protected industry does not receive the expected advantage of the VER. The market situation does not change and may even worsen. Consequently the domestic industry will push for a VER with the new competitor. One example of this involves the Canadian automobile industries.

When Japan restricted its exports of automobiles to Canada, the Korean automobile imports to Canada increased to such an extent that the Koreans were able to take over the market share which was previously held by Japan. Canada did not benefit from the VER with Japan. It subsequently requested that Korea restrain its exports to Canada.

The second situation which prompts new VERs occurs when the restricted exporting country shifts its displaced exports to a third country.<sup>141</sup> The third country, in order to protect its market against these increasing imports, will seek to negotiate a VER. Thus, once instituted, VERs multiply in the affected production sector.<sup>142</sup>

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<sup>139</sup> Michel Kostecki, *supra*, note 25 at 440.

<sup>140</sup> Reinhard Quick, *supra*, note 16 at 63.

<sup>141</sup> *Ibid.* at 64 and 171.

<sup>142</sup> Brian Hindley in John Black and Brian Hindley, *supra*, note 21 at 59.

When Japan and the United States agreed to a VER on automobiles in 1981, Canadian automobile industries were afraid of a diversion of Japanese cars to Canada as an outcome of this agreement.<sup>143</sup> The Canadian government therefore requested the Japanese government to restrict its automobile exports to Canada as well.

Cases in which VERs have been terminated for a product or even a trade sector are rare. The United States ended their VER on automobiles with Japan in 1985. Nevertheless, both governments stay in close contact to monitor the development of automobile exports.

#### f. Dispute Settlement

VERs do not embody or regulate any dispute settlement for the parties, nor do they provide any other form of conciliation.<sup>144</sup> GATT provides special procedures for settling trade disputes, set forth in Articles XXII and XXIII.<sup>145</sup> Article XXII requires the contracting parties to be open to consultations with respect to any matter affecting the operation of the GATT agreement.

Article XXIII regulates the procedure following complaints of the "Nullification or Impairment" of an agreement.<sup>146</sup> If bilateral consultations, as described in Article XXII, do not lead to a satisfactory adjustment, the matter is referred to the "CONTRACTING PARTIES." They will

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<sup>143</sup> It will be referred to the example in more details in: 2. Chapter under point 2. Automobile Industry.

<sup>144</sup> Reinhard Quick, *supra*, note 16 at 280.

<sup>145</sup> See Kenneth W. Dam, *supra*, note 45 at 356-368.

<sup>146</sup> Frank Stone, *supra*, note 3 at 38: Article XXIII goes much further than Article XXII.

investigate and make appropriate recommendations to the disputing parties.<sup>147</sup> If the recommendations are not followed, the "CONTRACTING PARTIES" may authorize the impaired state to take retaliatory measures against the other party such as "to suspend concessions or other obligations under this Agreement"<sup>148</sup>

Articles XXII and XXIII of GATT have never been applied against VERs.<sup>149</sup> There are several reasons why countries do not intervene against VERs.<sup>150</sup> First, the restrained exporting country voluntarily imposed the measure on its own production. It will not complain against itself in a dispute settlement.<sup>151</sup>

Second, the importing country in the majority of cases agreed with the exporting country about the restriction. Its industries benefit from the agreement which was initiated by them. Thus, the importing country has no interest in a dispute settlement under GATT either.<sup>152</sup> If the exporting side does not keep to the agreed quota, the importing side will settle the problem in bilateral consultations, and, if necessary, make use of coercive measures.

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<sup>147</sup> Article XXIII, 2. paragraph.

<sup>148</sup> Kenneth W. Dam, *supra*, note 45 at 364-368.

<sup>149</sup> Reinhard Quick, *supra*, note 16 at 276.

<sup>150</sup> *Ibid.* at 276-277;

<sup>151</sup> John H. Jackson, *Legal Problems of International Economic Relations* [:] *Cases, Materials and Text on the National and International Regulation of Transnational Economic Relations* (American Casebook Series) 2d edition (St. Paul, Minn.: West Publishing Co., 1986) at 614.

<sup>152</sup> Michel Kostecki, *supra*, note 25 at 438.

Third, other countries could take proceedings against a VER of two other contracting parties. To conduct a dispute settlement under Article XXIII, third parties must establish that they have been harmed by the agreement.<sup>153</sup> Typically, however, they benefit from the restraint of other competitors. Through the reduction of exports by the restrained country, they are able to enlarge their own market shares. A complaint against VERs could result in import quotas; a negative for them, since the importing country could decide to replace a VER by an GATT Article XIX global quota. Because of the possible negative implications for their own exports, they do not complain.<sup>154</sup>

Third parties may be affected when goods are diverted towards their country as a result of a VER between two other countries.<sup>155</sup> To date, no such affected country has ever complained against a VER under Article XXII or Article XXIII of GATT. Instead, they counter the increase in imports either by an Article XIX action or by a VER with the new competitor. They would themselves take away the latter possibility if they proceeded against VERs.<sup>156</sup>

In 1976, the American Iron and Steel Institute complained before government trade officials that Japan was shifting its steel products to the United States as a consequence of a VER concluded between Japan and the European Community for Iron and Steel.<sup>157</sup> The Institute argued that the bilateral agreement, by discriminating against third parties, violates section 301 of the Trade Act

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<sup>153</sup> John H. Jackson, *supra*, note 151 at 614.

<sup>154</sup> Michel Kostecki, *supra*, note 25 at 434.

<sup>155</sup> Reinhard Quick, *supra*, note 16 at 276.

<sup>156</sup> *Ibid.* at 277.

<sup>157</sup> Misao Tatsuta, *supra*, note 69 at 346.

of 1974. A related lawsuit was terminated in 1978 as no evidence of a substantial shift of Japanese steel exports towards the United States market was found.

The disadvantaged consumers in the importing country are not allowed to complain under Article XXIII, because this Article, and GATT in general, only applies to the contracting states. In addition, consumers are not aware of, or do not devote the necessary attention to, the impact of VER's, because the economic costs of these measures usually are not apparent to them.<sup>158</sup>

VERs have not yet been subject to dispute settlement under GATT and rarely have been attacked by third parties. The fact that VERs have never been investigated in a legal proceeding may be a reason for their continued existence.

#### 4. Why Do Exporters Agree to VER Agreements?

Ostensibly, countries which agree to restrain their exports do not act from a rational economic point of view. They decide to limit the quantity of exports they could otherwise supply to the importing country. The exporters lose market shares and possible profits. They are called "voluntary" agreements, but this expression does not hold true.<sup>159</sup>

Indeed, many exporting countries are put under pressure with the political threat of protectionist measures such as

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<sup>158</sup> John H. Jackson, *supra*, note 151 at 612-613.

<sup>159</sup> C. Fred Bergsten, *supra*, note 70 at 240. He and many other authors therefore use the word voluntary with quotation marks.

unilateral imposed quotas<sup>160</sup> or safeguard actions according to Article XIX of GATT.<sup>161</sup>

To be restricted unilaterally by import tariffs or quantitative import restrictions is worse than a VER.<sup>162</sup> Import quotas are tighter, which means fewer products can be exported than under a VER. The negotiation of VERs has the effect of setting the level of exports somewhat higher than it would be if the importing country chose a unilateral action.<sup>163</sup> VERs are more flexible protectionist instruments than fixed quantitative import quotas.<sup>164</sup> In addition, unilaterally imposed quotas often last longer than VERs, which are renewed on an annual basis.

In sectors like textile and clothing, where VERs last three or more years, the contracting parties include growth and flexibility provisions in the agreement.<sup>165</sup> "Growth" means that the quota level is increased annually by agreed growth rates. The flexibility provisions can be subdivided into swing, carry-over and carry-forward provisions. "Swing" means that the restraint level may be exceeded under the condition that an equivalent amount is deducted from another restrained product.

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<sup>160</sup> Jan Tumlr, *Protectionism*, supra, note 17 at 39, demonstrates how a possible bluff by the importing country could proceed.

<sup>161</sup> Victoria Curzon Price, supra, note 22.

<sup>162</sup> Robert K. Paterson, *Canadian Regulation of International Trade and Investment* (Toronto: Carswell, 1986) at 261.

<sup>163</sup> A. J. Sarna, supra, note 35 at 364.

<sup>164</sup> Gary H. Perlow, supra, note 43 at 96.

<sup>165</sup> See Canada, *Textiles and Clothing*, supra, note 27 at 213.

The "carry-over" provision allows taking any restraint level which was not used during the year and adding it to the level of the same product for the following year. "Carry-forward" enables the exporting side to exceed the limited quantity of a product during the year, provided that the amount is deducted from the restraint level of the same product for the following years. For all the provisions, it has to be noted that the restraint quantum can only be increased within an agreed percentage limit.

One reason countries agree to VERs is that they fear judicial action by the importing country. Such countries often initiate domestic investigations to make sure that low cost imports have not been dumped or subsidized by the exporting country.<sup>166</sup>

Exporting countries may also be threatened by the importing country's possible passage of legislative measures. Such measures could seriously reduce the quantity of exports. Legislative measures influence not only the trade decisions of the developing countries but also the behaviour of the industrialized states.<sup>167</sup> Some examples

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<sup>166</sup> Anti-dumping investigation against Hyundai which will be discussed further below.

<sup>167</sup> Report of the Chairman of Safeguards Committee, B.I.S.D., 30th Supplement (1984) 216 at 218. "...countries which accepted the so-called 'grey area' actions did so primarily because, even if they were satisfied that the requirements of the GATT safeguard provisions had been met, they felt they had little choice and that the alternative was, or would have been, unilateral action in form of quantitative restrictions, harassment by anti-dumping investigations, countervailing action, enforcement of pricing mechanisms, etc., involving greater harm to their exports in terms of both, quantity and price."

taken from the trade in automobiles illustrate this point.<sup>168</sup>

During the negotiations of a VER on passenger cars between the United States and Japan in 1980, U.S. bill No. 396 was introduced in Congress to impose mandatory quotas on Japanese automobile exports.<sup>169</sup> Canada, in order to force Japan to accept a similar agreement on automobiles, slowed down and hampered customs clearance at the Vancouver docks in 1981.<sup>170</sup> As a result, the Japanese government agreed to both VERs.

Besides unilateral import restrictions and other coercive measures, Canada and the United States could have strengthened pressure on Japanese auto producers in the Free Trade Agreement. The Free Trade Agreement was concluded on October 4, 1987 between the United States and Canada to bilaterally abolish tariff and non-tariff barriers.<sup>171</sup> During the negotiations it became certain that both countries eventually intended to raise the obligatory local

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<sup>168</sup> Examples can also be found in other trade sectors. Interesting in this respect is the description of the origin of the U.S.-Canada Potato Agreement of 1948 in Stanley D. Metzger, *supra*, note 44.

<sup>169</sup> See H.R. 7957, 96th Cong. 2d session (1980) also called the Danforth Bill; for further details, see Frank Langdon, *The Politics of Canadian-Japanese Economic Relations, 1952-1985* (Vancouver: University of British Columbia Press, 1983) at 49.

<sup>170</sup> *Ibid.* at 51.

<sup>171</sup> The Free Trade Agreement was signed on December 10, 1987. It entered into force on January 1, 1989, Canada-United States Free Trade Agreement Implementation Act, S.C. 1988, ch. 65. It covers, among others, the following points: (1) abolition of tariffs in 10 years; (2) elimination of import and export restraint and other non-tariff barriers; (3) liberalization of investment; and (4) establishment of a special agency for dispute settlement.

parts procurement ratio applicable to Japanese and other foreign auto makers from 50 percent to 60 percent.<sup>172</sup>

This would have driven Japanese car manufacturers into a more difficult position in terms of production costs. In the Free Trade Agreement, only 50 percent of the direct production costs of any automobile have to be incurred in Canada and the United States to qualify for a duty-free treatment.<sup>173</sup> Under the United States-Canada Automobile Agreement (Auto Pact),<sup>174</sup> the rule for imports into both countries had only required that 50 percent of the invoice price be incurred in Canada or the United States.<sup>175</sup> The new 50 percent ratio under the Free Trade Agreement is equivalent to a 70 percent requirement on the old basis. Foreign auto manufacturers will therefore have to produce or buy more local parts in North America than before.

The Auto Pact and the Free Trade Agreement are bilateral agreements. To enjoy the privileges of the Auto Pact, foreign car manufacturers have to join the agreement. Except for Suzuki Motor Co. which agreed to a joint venture in Canada with General Motors, no Japanese producer can hope to join the United States-Canada Automobile Agreement.<sup>176</sup>

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<sup>172</sup> Sankei and Nikkan Kogyo, November 26, 1987.

<sup>173</sup> Section XVII of Annex 301.2: rule of origin for transport materials.

<sup>174</sup> Agreement between the Government of Canada and the Government of the United States of America on Automotive Products, signed at Johnson City January 16, 1965; Entered into force provisionally January 16, 1965; Entered into force definitively September 16, 1966. Canada Treaty Series 1966 No.14; 606 UNTS 31; TIAS 6093; 4 ILM 302 (1965)

<sup>175</sup> Auto Pact, Annex B.

<sup>176</sup> Sankei and Nikkan Kogyo, November 26, 1987.

Thus far, we have only discussed situations in which the importing country's government would threaten the exporting country to force the adoption of VERs. In addition, there are cases where VERs are agreed to voluntarily because the exporting side considers it a welcome economic instrument.<sup>177</sup> Representatives of well-established textile firms in Japan for example, pressed visiting foreign government officials, who were complaining about the number of Japan's textile exports, to seek a VER on textiles from the Japanese government.<sup>178</sup>

The advantage these representatives expected from a VER was the cartelization of all textile industries. The old established companies, which are often the largest, receive the main quota shares in a cartel. The competitive newcomers only receive a restricted number of shares, as they are distributed according to the firm's actual export numbers. The young industries have no possibility under a VER to raise their export capacities. They would not endanger the leading competitive companies in terms of production and costs. These established companies could take over price leadership regardless of young and successful industries, because of their guaranteed market share.

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<sup>177</sup> Brian Hindley, *supra*, note 24 at 320: profitability for exports.

<sup>178</sup> Jan Tumlr, *Protectionism*, *supra*, note 17 at 40.

## 2. CHAPTER: VER AGREEMENTS INVOLVING CANADA

### 1. Textile and Clothing Industry

Canada's textile and clothing industries are the second largest manufacturing sector in Canada.<sup>179</sup> In 1981, the industries employed about ten percent of all Canadian workers.<sup>180</sup> Most of the producers are concentrated in the provinces of Quebec and Ontario.<sup>181</sup> They are located near big cities like Montreal and Toronto. Many smaller communities in these regions are dependant on the textile and clothing industries as their major employer.<sup>182</sup>

In Quebec for example, the textile and clothing industries are most significant, contributing to more than 20 percent of all manufacturing employment in this region.<sup>183</sup> For 22 communities in Quebec, textile and clothing represent between 20 to 76 percent of manufacturing employment.<sup>184</sup>

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<sup>179</sup> David R. Protheroe, *Imports and Politics: Trade Decision Making in Canada, 1968-1979* (Montréal: The Institute for Research on Public Policy, 1980) at 102.

<sup>180</sup> Canada, *A Review of Canadian Trade Policy: A Background Document to Canadian Trade Policy for the 1980's* (Ottawa: Minister of Supply and Services, 1983) at 94 [hereinafter Canada, *Review of Canadian Trade Policy*].

<sup>181</sup> David R. Protheroe, *supra*, note 179 at 38.

<sup>182</sup> A. J. Sarna, *supra*, note 35 at 367.

<sup>183</sup> Canada, *Review of Canadian Trade Policy*, *supra*, note 180 at 94. In Ontario the textile and clothing industry accounts for seven percent of all manufacturing employment.

<sup>184</sup> *Ibid.*

### a. Canada's Import Policy

Canada's nominal tariffs on textiles and apparel are the highest tariffs in Canada for any industry.<sup>185</sup> Currently, Canada has an average of 18.2 percent of tariffs for the textile industry, compared to 10.4 percent in the United States.<sup>186</sup>

Nevertheless, the Canadian textile and clothing industries, like their counterparts in other developed countries, have suffered from mass imports from "low-cost" countries.<sup>187</sup> The extreme wage differences between Canadian firms and companies in developing countries<sup>188</sup> make it hard for domestic firms to compete in the market.<sup>189</sup>

In 1970, the Canadian government adopted for the first time a textile and clothing policy to support the domestic industries. It was composed of a programme of adjustment assistance for the domestic industries and it included the option of applying temporary protectionist measures to

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<sup>185</sup> The textile and clothing tariff rates are three times as high as those for the entire manufacturing sector. The average rates are 24 percent on clothing, 21.5 percent on fabrics and 13 percent on yarn, see Government of Canada, News Release No.137 from July 30, 1986 at 2.

<sup>186</sup> Canada, Department of Finance, March 22, 1988, "Tariff Relief for the Textile and Apparel Industries", Fact Sheet at 2.

<sup>187</sup> Edmond McGovern, *supra*, note 89 at 507.

<sup>188</sup> Especially East Asian countries like Korea, China, Taiwan and Hong Kong.

<sup>189</sup> David R. Protheroe, *supra*, note 179 at 102: Labor costs in Canada are very high even compared to other industrial countries. Only Sweden has higher wages per hour than Canada.

support the adjustment process.<sup>190</sup> One result of the new textile and clothing policy was the Textile and Clothing Board, established in 1971 by the Textile and Clothing Board Act.<sup>191</sup>

#### 1) Textile and Clothing Board

The Textile and Clothing Board (TCB) functioned as a supervising agency for the development of Canadian textile and clothing industries.<sup>192</sup> If industry representatives request protection, the TCB will determine whether or not certain imports of a supplier country are causing injury or threatening injury to domestic manufacturers. After a positive finding, the TCB suggests special measures for protection to the Minister of Industry, Trade and Commerce.<sup>193</sup>

The procedures of the three-member TCB are public, and importers and exporters are free to participate.<sup>194</sup> Canadian textile and apparel industries make recommendations to the TCB whenever they feel that foreign competitors are

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<sup>190</sup> For further details, *ibid.* at 105-106.

<sup>191</sup> The Textile and Clothing Board Act (S.C., 1970-71-72, c. 39) repealed by the Canadian International Trade Tribunal Act (S.C., 1988 c.56 s.51). The Tribunal was formed from the amalgamation of the Canadian Import Tribunal, the Tariff Board and the Textile and Clothing Board.

<sup>192</sup> David R. Protheroe, *supra*, note 179 at 59-63.

<sup>193</sup> Caroline Pestieau, *The Canadian Textile Policy: A Sectoral Trade Adjustment Strategy?* (Montréal: C.D. Howe Institute, 1976) chapter six [hereinafter Caroline Pestieau, *The Canadian Textile Policy*].

<sup>194</sup> Except for the adjustment plans of companies, which are treated or discussed confidentially, see David R. Protheroe, *supra*, note 179 at 50.

gaining market shares. The Board is expected to analyze the recommendations from the point of views of Canadian consumer interests, and Canada's obligations under GATT and the MFA.<sup>195</sup> The Board has been criticized by the Canadian Consumer Association and Canadian Importers for being too responsive to domestic textile and apparel industries' interests.<sup>196</sup>

In 1971, the TCB suggested that the Canadian government initiate an Article XIX safeguard action under GATT.<sup>197</sup> The government acted accordingly, seeking Canada's first Article XIX protection in textiles and clothing.<sup>198</sup> An Article XIX safeguard was granted in November 1971 against imports of men's and boy's shirts with tailored collars.<sup>199</sup>

Since the 1970's, the textile and clothing sector has been in a recession.<sup>200</sup> Not only the increase in imports, but also a decrease in consumer demand were responsible for the economic situation in this sector.

In 1976, the TCB recommended in an interim report the immediate enforcement of global quantitative restrictions on clothing imports under the Exports and Imports Permit

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<sup>195</sup> Robert K. Paterson, *supra*, note 162 at 88.

<sup>196</sup> Caroline Pestieau, *The Canadian Textile Policy*, *supra*, note 193 at 30-31.

<sup>197</sup> For the development of the Canadian textile and clothing industry and the situation of the Canadian textile and clothing market, see Frank Langdon, *supra*, note 169 at 38-39.

<sup>198</sup> A. J. Sarna, *supra*, note 35 at 357.

<sup>199</sup> *Ibid.*

<sup>200</sup> *Ibid.* at 365.

Act.<sup>201</sup> The Canadian government followed the Board's report and imposed global quotas on the importation of 14 categories of clothing accounting for some \$600 million in trade.<sup>202</sup> The measure was taken under Article XIX of GATT. Accordingly, the restrictions were invoked on a non-discriminatory basis against all supplier countries.

Canada's action was criticized by GATT member states whose clothing exports were affected by the global restriction. Both the developing countries and the United States claimed that Canada acted contrary to the MFA. Canada later agreed to compensate the United States for the damages caused to its exporting industries.<sup>203</sup> The measure was applied by Canada for three years until 1979. It was replaced by VERs with the major exporting nations of textile and clothing.<sup>204</sup>

## 2) Government Support in the 1980's

The increase of exports from Third World countries had vast economic effects for the industries in the developed countries. Large amounts of textiles and apparels flooded the Canadian market after the 1982 recession, further weakening Canadian manufacturers.<sup>205</sup> The Canadian clothing

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<sup>201</sup> See Canada, *Clothing Inquiry: A Report of the Minister of Industry, Trade and Commerce* (Ottawa: Textile and Clothing Board, 1977)

<sup>202</sup> Canada, Department of Industry, Trade and Commerce, Press Release No. 113-76 from November 29, 1976. See also, Frank Langdon, *supra*, note 169 at 42-46: The Global Quotas of 1976.

<sup>203</sup> Frank Stone, *supra*, note 3 at 109.

<sup>204</sup> *Ibid.*

<sup>205</sup> Government of Canada, News Release No. 137, July 30, 1986 at 1.

industry lost market shares to imports on a unit volume basis from 69 percent in 1981 to 57 percent in 1985.<sup>206</sup>

It is estimated that approximately 15,000 Canadians employed in the textile industry have lost their jobs since 1981.<sup>207</sup> Between 1981 and 1985, imports of Third World countries to Canada averaged at a growth rate of 11 percent a year which was five times as much as the total annual market growth.<sup>208</sup> In 1983, the growth rate of low-cost imports was at a high with 26 percent.<sup>209</sup>

In 1981, the Canadian government announced a new textile and clothing policy for the 1980's.<sup>210</sup> It was composed mainly of two elements.<sup>211</sup> First, a five year period of adaptation was provided for Canadian industries to bring adjustment under way free of the threat of disturbance by low price imports. Second, to support adjustment measures during that time, 250 million Canadian dollars were granted under the Canadian Industrial Renewal Board in "direct industry modernization assistance." The Industrial Renewal Board was specially established in 1981 to help restructure the textile and clothing firms and to find employment opportunities for released workers.<sup>212</sup> In

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<sup>206</sup> *Ibid.*

<sup>207</sup> *Ibid.*

<sup>208</sup> *Ibid.* at 2.

<sup>209</sup> *Ibid.* In 1984, the growth rate of imports was 15 percent.

<sup>210</sup> Government of Canada, News Release: "Government Policy for the Textile and Clothing sectors", Ottawa and Montréal, 19 June 1981.

<sup>211</sup> Canada, *Review of Canadian Trade Policy*, *supra*, note 180 at 93-94.

<sup>212</sup> *Ibid.* at 94.

addition, 300 million Canadian dollars were invested in labour and community adjustment programmes.

Canada's high textile tariffs, twice as high as those in other developed countries, caused problems for the clothing and furniture industries. The imported textiles in Canada were too expensive, and thus the input costs for Canadian manufacturers were too high. Canada's Minister of Finance, Michael Wilson, therefore declared on March 22, 1988 a tariff relief for the textile and apparel industries.<sup>213</sup> The measure was taken in order to strengthen the position of Canadian textile and clothing industries in the domestic market against cheap imports from foreign suppliers.

The new programme calls for an immediate tariff reduction on 13 specialty fabrics and yarns not made in Canada, a future reduction of tariffs to levels which will be comparable to those of other industrial countries, and new duty remission programmes. The tariff reductions on the specialty fabrics will allow Canadian manufacturers to reduce their input costs on foreign fabrics. The savings for Canadian industries is expected to be approximately 14 million Canadian dollars a year.<sup>214</sup>

Over the next ten years Canada's high tariff rates will be cut down, starting on January 1st, 1990 with the first round of textile tariff reductions. The new duty remission will amount to about 33 million Canadian dollars annually.<sup>215</sup>

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<sup>213</sup> Canada, Department of Finance, Information from March 22, 1988: Tariff Relief for the Textile and Apparel Industries.

<sup>214</sup> *Ibid.* at 2.

<sup>215</sup> *Ibid.* at 3.

As a result of the new duty remission programme, more foreign textile and apparel products will enter the Canadian market. They will bring more competition for domestic manufacturers. However, Canadian textile and apparel industries can mix their products with less expensive imports. The Canadian consumer is offered a broader range of products at competitive prices. The reduction and elimination of tariff barriers is a move towards free trade in this trade sector.

### 3) Summary

The Canadian textile and apparel policy since 1981 has not been as effective as expected. The average import rate growth since 1982 has been 11 percent compared to a total market growth of only 2.3 percent.<sup>216</sup> After the recession in 1982, imports increased more than before and put Canadian industries in a deep crisis. New supplying countries appeared on the Canadian market, such as Bangladesh, Sri Lanka, Turkey and Indonesia. The five year period of adaptation did not bring expected results. The Canadian textile and clothing industries continue to struggle for their existence.

The 1988 policy does not seem to be any more successful in bringing relief for the domestic industries. Canadian textile and clothing industries today are not able to compete with low price products of developing countries. It is doubtful whether another period of adaptation would be able to change the present situation.

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<sup>216</sup> Government of Canada: New Textile and Clothing Import Policy, News release No.137 from July 30, 1986 at 1.

## b. Canada and the Multi-Fibre-Agreement

Textiles and clothing is a very competitive field of trade. Most of the developing countries are involved in their production. In 1982, international trade in textiles and clothing amounted to five percent of world trade and ten percent of world trade in manufacturing products, with a total of 51.5 and 41 billion dollars respectively.<sup>217</sup>

The MFA, first formed in 1974, proposed to liberalize international trade in textiles and clothing and to reduce trade barriers in this sector. The developing countries in particular aimed at gaining economic growth through an increase of their exports. It therefore reconciled the interests of the importing and exporting countries and guaranteed orderly and equitable development while avoiding market disruptions as a result of mass imports. The safeguard mechanism established under Articles 3 and 4 of the MFA allows the states to arrange bilateral agreements to avoid market disruption.

Article 3 expresses that the contracting parties shall not introduce new restrictions on trade in textiles "unless such action is justified under the provisions of this article." Only actual market disruptions are covered by this article. In cases of possible future market disruptions, Article 4 can be invoked.

Art 4 (2) of the MFA allows the member countries to agree on VERs "in order, on the one hand, to eliminate real risks of market disruption in importing countries and disruption to the textile trade of exporting countries, and on the other hand to ensure the expansion and orderly

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<sup>217</sup> GATT, Report on Textile and Clothing in the World Economy, Geneva, 1984.

development of trade in textiles and the equitable treatment of participating countries."

The term "market disruption" is the key principle for both articles.<sup>218</sup> It is defined in Annex A of the MFA "as serious damage to domestic producers or actual threat thereof." The factors causing market disruption are described as (1) a sharp and substantial increase or imminent increase in imports of particular products from particular sources where (2) these products are offered at prices which are substantially below those prevailing for similar goods of comparable quality in the market of the importing country.<sup>219</sup>

To assist the domestic textile and clothing industries, the Canadian government negotiated VERs with a number of exporting countries. In 1966, Canada had bilateral agreements with six countries. The number of countries grew to twenty in 1971.<sup>220</sup> In 1975, Canada negotiated bilateral agreements with only eleven countries. The number of products subject to agreements was reduced from nineteen in 1972 to fifteen in 1975.<sup>221</sup> In 1976, Canada imposed global quantitative restrictions under Article XIX GATT. In 1979, Canada replaced the global quotas on textile and clothing by VERs under Article 4 of the MFA.

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<sup>218</sup> Martin Wolf, *supra*, note 12 at 7.

<sup>219</sup> Annex A II.

<sup>220</sup> Klaus Stegemann, *Canadian Non-Tariff Barriers to Trade* (Montréal: Private Planning Association of Canada, 1973) at 10-13. In comparison, in 1971, the United States had VERs with 30 countries, the United Kingdom with 10, France with 3, Germany with 4, and Austria with 8. See, GATT, Document L/3797, Chapter VII and Annex I (1972).

<sup>221</sup> Caroline Pestieau, *The Canadian Textile Policy*, *supra*, note 193 at 35.

In 1981, Canadian government representatives re-negotiated VERs with 18 countries.<sup>222</sup> These supplier countries were: Brazil, Bulgaria, Hong Kong, China, Hungary, Czechoslovakia, India, Republic of Korea, Macao, Malaysia, Pakistan, Philippines, Poland, Rumania, Singapore, Taiwan, Thailand and Uruguay. The products covered by VERs ranged from one product to all textile and clothing exports of the restrained countries.<sup>223</sup>

On January 1, 1987, Canada concluded VERs with twenty-two developing countries for a period of five years.<sup>224</sup> They included new textile and clothing exporting nations such as Indonesia, Bangladesh, Turkey and Sri Lanka. The Minister for Regional Industrial Expansion, Michel Côté, expressed the textile and clothing import policy this way: "We cannot hide from the realities of international competition in these or any other sectors, but we must ensure a more moderate pace of import growth which is consistent with an orderly adjustment process."<sup>225</sup>

Hong Kong, Korea and Taiwan are presently Canada's main suppliers, together accounting for 51 percent of all imports. China has moved to the fourth position with 12 percent of total imports. Canada's VERs cover about 90 percent of all clothing imports but only 7 percent of all

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<sup>222</sup> Canada, *Sommaire des ententes bilaterales du Canada prevoyant des restrictions sur les importations: Textiles et vêtements* (Ottawa, External Affairs, July 1983)

<sup>223</sup> Canada, *Review of Canadian Textile Policy*, supra, note 180 at 138.

<sup>224</sup> Canada, *Textiles and Clothing*, supra, note 27 at 1.

<sup>225</sup> Government of Canada: News release No. 137 from July 30, 1986 at 1.

textile imports.<sup>226</sup> The different treatment of clothing and textiles is due to two major interests of the clothing industry. Manufacturers would like to receive protection for their end products against imported clothing products, but need inexpensive imports of textiles for production.<sup>227</sup>

## 2. Automobile Industry

The Canadian automobile industry today mainly consists of five manufacturers: Ford Canada, General Motors Canada, Chrysler Canada, Volvo Canada and Honda Canada. Chrysler Canada and General Motors Canada are 100 percent owned subsidiaries of their American corporations. The United States Ford Motor Company owns 94 percent of Ford Canada.<sup>228</sup> As the industry structure indicates, the Canadian and United States automobile manufacturers are closely related to each other.<sup>229</sup>

The automobile industry, like the textile and clothing industry, is a major employer in Canada.<sup>230</sup> It is also the motor of the economy for many other industrial sectors, like synthetic rubber, wire products and aluminium products.<sup>231</sup>

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<sup>226</sup> Canada, *Review of Canadian Trade Policy*, supra, note 180 at 94. About 90 percent of U.S. and EEC textiles and clothing imports from developing countries are restricted by VERs.

<sup>227</sup> David R. Protheroe, supra, note 179 at 39.

<sup>228</sup> See Statement of reasons by Robert J. Bertrand before the Canadian Import Tribunal in a Dumping Inquiry against Hyundai, Inquiry No. CIT-13-87 from March 23, 1988 at 4-5.

<sup>229</sup> Peter Wong, supra, note 62 at 299.

<sup>230</sup> Canada, *Review of Canadian Trade Policy*, supra, note 180 at 101.

<sup>231</sup> *Ibid.* at 101-102.

### a. Automobile Exports by Japan to Canada

Canada's automobile trade with Japan was influenced by the behaviour of the United States vis-à-vis Japan. Due to their proximity, the United States and Canadian automobile markets are often treated as one North American market.<sup>232</sup> The development of the United States automobile market, which is ten times the size of the Canadian market, influences the latter one. A restricted American market affects Canada's automobile industries, as they may fear a shift of exports to the Canadian market.<sup>233</sup> In the following, the development of Canadian automobile trade relations with Japan will be analyzed from a North American perspective.

#### 1) Development of the North American Automobile Market

The United States automotive industries have been in a depression since the end of the 1970's.<sup>234</sup> U.S. automobile manufacturers recorded a loss of more than four billion dollars. Production decreased by about 30 percent and one million workers lost their jobs.<sup>235</sup>

The crisis was not limited to the United States. Canadian automobile industries suffered in the same way that their American neighbours did. Two factors were primarily

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<sup>232</sup> Wendy Dobson, ed., *Canadian-Japanese Economic Relations in a Triangular Perspective* (Montréal: C.D. Howe Institute, 1987) at 7.

<sup>233</sup> *Ibid.*

<sup>234</sup> Barbara Anne Sousa, "Regulating Japanese Automobile Imports: Some Implications of the Voluntary Quota System" (1982) 5 *Boston College International and Comparative Law Review* 431 at 434-435.

<sup>235</sup> Peter Wong, *supra*, note 62 at 297.

responsible for the poor sales of North American automobiles: the consecutive oil crises of 1973-74 and 1979 and the increase of automobile imports, mainly from Japan.

Consumers responded to higher oil prices during the oil crises by purchasing more fuel-efficient and smaller cars. Japanese producers exported large numbers of small passenger cars to the United States and Canada. They flooded the North American market at a time when the domestic car manufacturers had no equivalent products to offer. American production was still oriented towards large cars with high gas consumption. Japanese producers offered fuel-efficient cars which were in great demand by the consumers.

Japanese imports to Canada doubled in 1980 to 158,375 automobiles and continued to increase in 1981.<sup>236</sup> The same year, Japan reached a market share of 23.7 percent in the United States.<sup>237</sup> In 1982, imports amounted to 31 percent of the Canadian market and 29 percent of the United States market. More than 25 percent of Canadian imports originated from Japan.<sup>238</sup>

As consumer demand for domestic automobiles declined, Canadian car production fell from 1.0 million units in 1979 to 0.82 million in 1981. Consequently, employment decreased from 53,000 to 46,000 workers during this period.<sup>239</sup>

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<sup>236</sup> Frank Langdon, *supra*, note 169 at 48.

<sup>237</sup> William J. Hampton and James B. Trace, "Why Tokyo's Quotas Don't Do Detroit any Favour" *BusinessWeek* from March 3, 1986 at 38.

<sup>238</sup> Frank Langdon, *supra*, note 169 at 48.

<sup>239</sup> *Ibid.*

## 2) Canada's Import Policy

On a visit to Japan in August 1980, Canada's Minister of Industry, Trade and Commerce encouraged Japanese automobile producers to invest in new production plants in Canada.<sup>240</sup> The Japanese hesitated to invest in Canada for two reasons. They feared that trade barriers might hinder the uninterrupted access to the U.S. market, which they intended to supply from Canada. In addition, Canadian policies towards foreign investment had been subject to changes in the past, and therefore created insecurity among foreign investors.<sup>241</sup>

At the same time, in the United States, Ford Motor Company and the United Auto Workers Union argued before the International Trade Commission for a safeguard action under section 201 of the Trade Act of 1974 against Japanese automobile imports.<sup>242</sup> Section 201 of the Trade Act of 1974 empowers the President of the United States to impose quantitative restrictions on imports if they represent "a substantial cause of serious injury."<sup>243</sup>

The International Trade Commission decided on November 10, 1980 that the Japanese imports were not "a substantial cause of serious injury for the domestic industries," therefore import restrictions were not granted.<sup>244</sup> The

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<sup>240</sup> Japan Times Weekly, "Canada's Industry Minister Asks Car Firms to Invest" August 9, 1980 p.8

<sup>241</sup> Wendy Dobson, ed., *supra*, note 232 at 7.

<sup>242</sup> U.S.I.T.C., December 2, 1980. See Mitsuo Matsushita and Lawrence Repeta, *supra*, note 97 at 49.

<sup>243</sup> Trade Act of 1974, §204, 19 U.S.C. §§2101-2487 (1976).

<sup>244</sup> U.S.I.T.C. Publication 1110, December 2, 1980. Weinberg, "Imposing Import Restrictions Under Escape

Commission found that the decrease in sales of U.S. car manufacturers was caused by the general economic recession and by higher oil prices, which had increased demand for smaller fuel-efficient automobiles.

As a result, U.S. government officials held informal discussions with the Japanese government. In an exchange of letters on May 7, 1981, the Attorney General Frank Smith and the Japanese ambassador Yoshio Okawara notified each other about a possible VER by Japan on automobiles.<sup>245</sup> To support the negotiations, the Danforth bill was introduced in Congress in order to impose mandatory quotas on Japanese automobile imports.<sup>246</sup>

On May 1, 1981, the United States and Japan signed a three year VER agreement on automobiles. It was the first VER agreement in this trade sector worldwide. Japan agreed to limit its exports to 1.68 million passenger cars during the first year; this was equivalent to a 7.7 percent decrease in Japanese exports from 1980.<sup>247</sup>

The Canadian automobile industry followed the United States' negotiations with anxiety because they feared a diversion of Japanese automobiles from the restricted U.S. market to the Canadian market.<sup>248</sup> After the VER between the United States and Japan was signed, Canadian car

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Clause Provisions: A Case Study of the Automobile Industry" (1982) 12 California International Law Journal 325.

<sup>245</sup> The letters are reproduced in BNA ITIM No. 77 at M-1 (May 13, 1981).

<sup>246</sup> See Mitsuo Matsushita and Lawrence Repeta, *supra*, note 97 at 50. They describe the details of the U.S.-Japan negotiations.

<sup>247</sup> Frank Langdon, *supra*, note 169 at 50.

<sup>248</sup> Robert K. Paterson, *supra*, note 162 at 79.

manufacturers pressed their government to seek a similar agreement with Japan.<sup>249</sup>

On June 4, 1981, Japan agreed to reduce its passenger automobile exports to Canada by six percent to 174,213 cars between April 1, 1981 and March 31, 1982.<sup>250</sup> In 1982, the Canadian government asked Japan for a renewal of the agreement for at least another year. However, the Japanese delayed promising a new restriction of their exports.

Canada's response was a slow-down of customs clearance of Japanese shipments at the Vancouver docks.<sup>251</sup> After several months, Japan finally agreed to a VER for six months.<sup>252</sup> This initial agreement was later extended for another six months. From April 1982 to March 1983, Japanese exports were restricted to 153,000 units, which is equivalent to a reduction of 23.5 percent from 1981. Through 1984-85, Japanese imports were restricted to 170,401 units.

Between 1984-85, Japanese car sales to the United States have been limited to 1.85 million units. On March 31, 1985, the U.S. government decided to let the VER with Japan lapse. It did not request a renewal because U.S. manufacturers had succeeded in transforming a 1.3 billion dollar loss in earnings in 1981 into 8.1 billion dollars net profit in 1985. The VER may not have solved the problems of the U.S. automobile industry completely, yet it helped the

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<sup>249</sup> Wendy Dobson, *supra*, note 232 at 10.

<sup>250</sup> See Frank Langdon, *supra*, note 169 at 51 for more details about the negotiations of the first VERs by Canada and the United States with Japan.

<sup>251</sup> Wendy Dobson, *supra*, note 232 at 11.

<sup>252</sup> Frank Langdon, *supra*, note 169 at 52.

industry adjust to new import challenges in order to become more competitive.<sup>253</sup>

Canada did not follow the U.S. example. Instead, the VER with Japan was extended, limiting Japanese passenger car shipments to 18 percent of the Canadian automobile market in 1985-1986.<sup>254</sup> Japanese exports were further restrained in 1986 for another year to 21 percent.<sup>255</sup> The agreed annual level changed and increased during the years. The Japanese Automobile Association published the number of cars exported by Japan to Canada since the first VER in 1981. The statistic which is shown in form of a chart also includes the export numbers for the years 1971 to 1981. 1986.

b. Automobile Exports by Korea to Canada

Canadian automobile producers hoped they had reached a breathing space after Japanese imports had been restricted by VERs. However, the agreed VERs only limited the number of automobiles to be imported. They did not specify the type or value of the product. This had the effect, as noted earlier, that Japanese producers were selling medium sized and more expensive cars.<sup>257</sup> Due to the reduced quantity of exports, they phased out the smaller car segment at the

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<sup>253</sup> The U.S. decision was influenced in part, as well by the high costs for the consumer and the consumer, see John H. Jackson, *supra*, note 151 at 622.

<sup>254</sup> Hideo Sato, "A Japanese Perspective" in Wendy Dobson, *supra*, note 232 at 48.

<sup>255</sup> Nihon Keizei Shimbun, Tokyo, August 21, 1986.

<sup>256</sup> Keith A. Hay and S.R. Hill, Canada-Japan: The Export Import Picture (Ottawa: Canada-Japan Trade Council, 1980) Chart 24.

<sup>257</sup> See Chapter 1, d. under 1) Exporting Country.

bottom of the scale, thereby offering sale possibilities to new producers.<sup>258</sup>

Hyundai, a Korean car manufacturer, filled this market niche. In 1983, when Hyundai was still unknown, it began to ship 600 small automobiles to Canada.<sup>259</sup> The number of cars increased in 1984 to 31,000 and tripled one year later to 95,853 cars.<sup>260</sup> Hyundai sold more cars only in its home country, South Korea, namely 172,501 in 1985.

Hyundai's success in the first two years was due to the Pony, a small, relatively primitive model at a very low price. After some quality problems became known, sales dropped to 77,000 in 1986 and 32,000 in 1987.<sup>261</sup> Besides the Pony, Hyundai introduced the Stellar in Canada. The Stellar started to sell in 1985 with 28,000 units taking eight percent of the Canadian automobile market.<sup>262</sup> Due to quality problems with this model, only 16,000 Stellers were sold in 1986 and 9,500 in 1987.<sup>263</sup> Market share fell from five percent to three percent, respectively. The Pony and the Stellar are no longer imported.

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<sup>258</sup> The move to more expensive vehicles is influenced by the car-marketing concept called "Sloan Ladder." It states that consumers will stay with the same manufacturer and will purchase larger and more expensive over time. Therefore it is important for the manufacturer to offer a broad scale of cars, covering all the product segments.

<sup>259</sup> Statements of reasons in Finding of the Canadian Import Tribunal in Inquiry No. CIT-13-87 at 17.

<sup>260</sup> *Ibid.* at 17-18.

<sup>261</sup> *Ibid.* at 18.

<sup>262</sup> *Ibid.* at 19.

<sup>263</sup> *Ibid.*

Hyundai's strategy was to make all their mistakes in Canada before launching their cars in the United States.<sup>264</sup> In 1986, Hyundai started to sell the Excel in Canada and in the United States. The Excel was once again a low-priced model. Hyundai sold 168,000 Excels in the United States in 1986, 205,000 in the first nine months of 1987 and 208,000 during the same period in 1988.<sup>265</sup> Canadian dealers sold 40,000 cars in the first nine months of 1987 and 24,000 during the same period in 1988.<sup>266</sup>

Canadian automobile manufacturers noticed the movement of Canadian customers toward the cheap foreign Pony, Stellar and Excel. In 1986 officials of the Canadian government tried to persuade the Koreans to restrain their imports into Canada. The Korean government failed to agree to a VER in either 1986 or 1987.

#### c. Anti-dumping Investigation against Hyundai

General Motors of Canada and Ford Motor Company of Canada submitted a complaint to the Deputy Minister of National Revenue for Customs and Excise to initiate an anti-dumping investigation under the Special Import Measures Act (SIMA).<sup>267</sup> The automobile manufacturers argued that Hyundai Motor Company, and its associated companies, were dumping Korean-manufactured cars into the Canadian market. On July 15, 1987, the Deputy Minister responded by initiating an

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<sup>264</sup> The New York Times from November 2, 1988, "Hyundai's Bid to Move Up in Class" in Business Day at D1, continued at D9.

<sup>265</sup> *Ibid.*

<sup>266</sup> *Ibid.*

<sup>267</sup> SIMA is in force since 12th December 1984, SI/84-232: Canada Gazette, Part II, Vol. 118, No.25.

anti-dumping investigation with regard to cars shipped between January 1, 1986 and March 31, 1987.<sup>268</sup>

On November 24, 1987, the Deputy Minister notified the Canadian Import Tribunal of its preliminary determination of dumping. Subsequently, pursuant to section 42(1) SIMA the Canadian Import Tribunal conducted an inquiry.<sup>269</sup>

In hearings before the Canadian Import Tribunal, the counsel on behalf of the complainants argued that Hyundai priced its cars below all competitive models in Canada. The complainants thereby suffered injury in the form of price suppression and profit margin erosion.<sup>270</sup> The domestic manufacturers also contended that continued dumping by Hyundai would result in future injury, especially to Ford Canada, in the form of price suppression, margin erosion, reduced employment, reduced utilization of capacity and reduced production. Hyundai's sales in 1986 increased by nearly 180 percent over 1984 although the market growth only amounted to 19 percent.<sup>271</sup> This, it was urged, could only be achieved through dumping. Hyundai denied the claims of injury reported by General Motors and Ford Canada, contending that the Canadian industries had no comparable products on the market which could be injured.<sup>272</sup>

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<sup>268</sup> See Statement of reasons accompanying the Finding of the Canadian Import Tribunal in Inquiry No. CIT-13-87 under Section 42 of the Special Import Measures Act, March 23, 1988 at 1.

<sup>269</sup> *Ibid.* at 2. For the procedure in dumping investigations under SIMA in general see Robert K. Paterson, *supra*, note 162 at 107-119.

<sup>270</sup> Finding of the Canadian Import Tribunal in Inquiry No. CIT-13-87, Statement of reasons at 7.

<sup>271</sup> *Ibid.*

<sup>272</sup> *Ibid.* at 9.

According to section 42(1)(b)(i)(A), the Import Tribunal has to inquire in the case of dumped goods, whether "there had occurred a considerable importation of 'like goods' that were dumped, which dumping has caused material injury or would have caused material injury except for the application of anti-dumping measures."<sup>273</sup> SIMA gives an interpretation of "like goods" in Section 2(1). "Like goods" in relation to any other good, means (a) goods that are identical in all respects to the other good, or (b) in the absence of any goods described in paragraph (a), goods the uses and other characteristics of which closely resemble those of the other goods."

The Canadian Import Tribunal examined the market for "like goods", analyzing market segments and Canadian production.<sup>274</sup> It further focused on the issue of material injury caused by Hyundai's imports to domestic production. The Tribunal found that Ford Canada lost market shares in the "like good" market to Hyundai. However these losses did not cause material injury to domestic automobile production. Hyundai's imports were considered to be only one of several factors in the very dynamic small car market.

According to section 43(1) SIMA, the Canadian Import Tribunal held that the dumping of the mentioned goods had not caused, was not causing and was not likely to cause material injury to the production in Canada of "like goods."<sup>275</sup>

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<sup>273</sup> According to Section 2(1) of SIMA, goods are "dumped", when the normal value of the goods exceeds their export price.

<sup>274</sup> Mini, basic, small, lower middle and upper middle car segments.

<sup>275</sup> March 23, 1988.

### 3. CHAPTER: VER AGREEMENTS AND GATT

VER agreements are very problematic with respect to GATT. VERs are likely to contradict at least three provisions of GATT. They may violate the non-discrimination principle laid down in Article I, the prohibition of quantitative restrictions of Article XI and the safeguard clause of Article XIX. Most of the studies which analyze the compatibility of VERs with GATT focus on these three articles.<sup>276</sup>

VERs are often regarded as trade measures falling outside the scope of GATT.<sup>277</sup> The Director-General of GATT said in 1984: "VERs are clearly contrary to the present rules of the General Agreement and are only 'outside the General Agreement' in the sense that governments have not brought them formally to GATT examination."<sup>278</sup>

#### 1. Trade without Discrimination

GATT's main principle is non-discrimination among all member states. It is embodied in the first Article, the Most-Favoured-Nation clause. The non-discrimination principle stands in contrast to bilateral agreements.<sup>278</sup>

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<sup>276</sup> Walter Werner, *Selbstbeschränkungsabkommen im Aussenhandel - Eine Untersuchung aus der Sicht des Völkerrechts, des EWG-Rechts und des deutschen Rechts* (Gelsenkirchen, Verlag Dr. Mannhold, 1984); Reinhard Quick, *supra*, note 16; Peter Wong, *supra*, note 62; for a recent analysis see Ernst-Ulrich Petersmann, *supra*, note 105 at 30.

<sup>277</sup> GATT, *The Tokyo Round*, *supra*, note 10 at 96;

<sup>278</sup> See GATT, Report of the chairman of Safeguards Committee, *supra*, note 167, Annex MDF/4.

<sup>278</sup> Ernst-Ulrich Petersmann, *supra*, note 38 at 113 ff.

The MFA allows GATT member states to make bilateral arrangements and agreements in the textile and clothing sector. Yet, the exceptions in the MFA may not be transferred to other trade sectors. Bilateral measures taken outside the MFA fall into the category of "grey area" measures.

a. Most-Favoured-Nation Clause

The Most-Favoured-Nation clause states that all member countries have to grant each other any advantage, favour or privilege which they give to any other country in relation to importation and exportation. No country is allowed to give any other country a trading advantage it does not share with all other member countries.<sup>280</sup> All countries are equal and therefore must receive the same benefits.

VERs are concluded in the form of bilateral agreements between the two countries concerned. Third parties who will certainly also be affected are not allowed to participate. Non-discrimination is transformed by VERs into a system of bilateral protection.<sup>281</sup> A fair and equal treatment of all countries does not exist under VERs. The question is whether a VER should be considered as an advantage, favour or privilege, as it is expressed in Article I of GATT.

For the exporting country, as it was shown, a VER may produce economic advantages. However, from an objective point of view, a restriction on trade is always disadvantageous vis-à-vis free trade.<sup>282</sup> VERs are

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<sup>280</sup> John H. Jackson, *supra*, note 8 at 255.

<sup>281</sup> Orr, *supra*, note 70.

<sup>282</sup> Peter Wong, *supra*, note 62 at 301.

advantageous for the importing country and for all other exporting countries.<sup>283</sup> The importing country benefits from a VER, because it gives its industries time to recapture lost markets and to adapt to new situations. The large economic costs could be construed as disadvantageous. However, it seems that they are taken, rather, as by-product.

All exporting countries have the advantage, vis-à-vis the restrained country, of not being restrained in their exports.<sup>284</sup> The restrained country is excluded from the general advantage of free trade. Therefore, VERs are not in accordance with the principle of non-discrimination in Article I of GATT.<sup>285</sup> Yet, it is argued that states which agree "voluntarily" to an unfavourable situation do exclude themselves from any advantage of trade. Article I does not prevent any country from putting itself in a disadvantageous position.<sup>286</sup>

However, each member country, even one which voluntarily restricts its exports towards another country, has to observe the Most-Favoured-Nation clause. In order to treat all countries equally, a country cannot restrain its exports to just one particular country, but has to do so in favour and for the advantage of all countries. This is laid down in Article XIII. "No ...restriction shall be applied by any contracting party ...on the exportation of any product destined for the territory of any other contracting party, unless ...the exportation of the like product to all

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<sup>283</sup> Barbara Anne Sousa, *supra*, note 234 at 440.

<sup>284</sup> Michel Kostecki, *supra*, note 25 at 434; Peter Wong, *supra*, note 62 at 301.

<sup>285</sup> Reinhard Quick, *supra*, note 16 at 264; Barbara Anne Sousa, *supra*, note 234 at 440.

<sup>286</sup> Peter Wong, *supra*, note 62 at 301.

third countries is similarly ... restricted." The principle of non-discrimination embodied in Article XIII for the administration of quantitative restrictions is violated by VERs.<sup>287</sup> Article XIII is only a specification or extension of the general principle of non-discrimination in Article I. Consequently, VERs also contradict Article I of GATT.

#### b. Multi-Fibre-Agreement

On July 31, 1986, the MFA was extended for a period of five years.<sup>288</sup> The MFA and its predecessors, the STA and the LTA, have governed the textile and clothing sector for almost thirty years now. At the end of the 1950's, world trade in textiles and clothing was dominated by country-to-country agreements. For most of the states, the textile and clothing sector is a very important part of the economy. In order to secure the future expansion of this sector, the states agreed to the MFA in multilateral negotiations under the auspices of GATT.<sup>289</sup>

However, the STA, LTA and the MFA did not bring trade in textiles and clothing under the general principle of non-discrimination. In this respect, the MFA embodies a derogation of GATT rules.<sup>290</sup> Member states may invoke safeguard provisions against any supplier country if their market is disrupted by imports. The most criticized

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<sup>287</sup> Ernst-Ulrich Petersmann, *supra*, note 105 at 31.

<sup>288</sup> See Protocol Extending the Arrangement Regarding International Trade in Textiles, Geneva 1986.

<sup>289</sup> See Chapter 1 above.

<sup>290</sup> UNCTAD, *supra*, note 15 at 10.

provisions in the MFA are Articles 3 and 4.<sup>291</sup> They open the way for bilateral VERs.

In Article 4 of the MFA, VERs found a legal basis. Therefore, the provision is considered to be a very important one by most of the developed countries. The majority of the member countries wish to eliminate all practices under the MFA which contradict GATT rules and a strict observation of the principle of non-discrimination.<sup>292</sup>

### c. "Grey Area" Measures

Except for VERs which are concluded in the textile and clothing sector under the MFA, there is no legal cover for these agreements. VERs concluded in the automobile sector, for example, do not find support in an exceptional safeguard clause such as Article 4 of the MFA. VERs are given the name of "grey area" measures particularly to designate that these measures are taken outside the scope of GATT.<sup>293</sup>

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<sup>291</sup> McGovern, *supra*, note 89 at 510-512.

<sup>292</sup> The GATT member states have decided that "the negotiations in the area of textiles and clothing shall aim to formulate modalities that would permit the eventual integration of this sector into GATT on the basis of strengthening GATT rules and disciplines...", see Trade Negotiations Committee Meeting at Ministerial Level in Montréal, December 1988, GATT MTN.TNC/7 (MIN) from December 9, 1988 at 8.

<sup>293</sup> M.C.E.J. Bronckers, *Selective safeguard Measures in Multilateral Trade Relations* (The Hague: T.M.C. Asser Institute, 1985).

## 2. Quantitative Restrictions

GATT contains a general prohibition of quantitative restrictions. Article XI of GATT lays down that "No prohibition or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party."

Since the "flat prohibition"<sup>294</sup> was established, quantitative restrictions, especially on imports, have been widespread. They have been the most frequently used trade barriers in international trade. The nations became aware of the adverse impact and discriminatory consequences of these restrictions. Therefore, they included in GATT a provision on elimination of all measures restricting trade.<sup>295</sup> Today, quantitative restrictions continue to be numerous in the textile, agricultural and steel trades. The most common restrictions are import quotas: the importing country introduces a unilateral quota for certain products.

VERs also function as a form of quantitative restriction through quotas.<sup>296</sup> VERs and import quotas have the same effect, in that they result in the suspension of international free competition, the limitation of manufacturing sales and a reduction in the demand for cheap sources of supply. However, VERs are different in form from the standard import quota. In a VER Agreement, two parties

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<sup>294</sup> Kenneth W. Dam, *supra*, note 45 at 150.

<sup>295</sup> Reinhard Quick, *supra*, note 16 at 266.

<sup>296</sup> Walter Werner, *supra*, note 276 at 30 ff.

agree that the exporting country restrain its exports at a certain level and commit itself to administer the quota limitation.

The importing country guarantees the exporting country importations of a certain good at a stipulated level under the VER. Most often it will assure the exporting country that it will not take unilateral action against it such as import quotas or anti-dumping investigations.<sup>297</sup>

The question arises whether or not Article XI is applicable to VERs as well.<sup>298</sup> VERs can be analyzed from two different points of view. On the one hand, a VER can be characterized as a quantitative restriction on exports by the exporting country. Article XI prohibits any restriction, through quotas or export licenses, on the exportation of any product through the exporting country. The distribution of the Japanese automobile quota by MITI in the form of export licenses contradicts Article XI.<sup>299</sup> The general idea is that every exporter should be free to export to any country as many products as he will be able to sell. The restriction of exports by a country is prohibited by Article XI.

On the other hand, a VER can also be characterized as a restrictive measure taken by the importing country. The importing country initiates consultation about a possible VER Agreement, and it is the most interested of both parties

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<sup>297</sup> This was a very important aspect in the negotiations on VERs on automobiles between the United States and Japan.

<sup>298</sup> GATT does not apply to VERs between two industries, see Ernst-Ulrich Petersmann, *supra* note 105 at 30.

<sup>299</sup> Peter Wong, *supra*, note 62 at 302.

in such an agreement. At this point, it may be pertinent to remember that the voluntariness of VERs is very doubtful.<sup>300</sup> Often the exporting country agrees to these agreements because it fears that otherwise the importing country would threaten its exports by applying unilateral measures.<sup>301</sup>

The export restriction taken by the importing country resembles another form of import restriction by the importing country.<sup>302</sup> It is different insofar as the importing country does not have to control and administer the quota. The effects are the same. The trade between two countries is restricted by quotas.

The language of Article XI covers import restrictions taken by the importing country as well.. "No... restrictions... shall be instituted... by any contracting party on the importations of any product of the territory of any other contracting party..." VERs, even if characterized as measures of the importing country, violate Article XI.<sup>303</sup>

At the time GATT was drafted, VERs may not have been considered a form of quantitative restriction under Article XI. Yet, the language of Article XI allows for a broad interpretation, covering all possible measures which are barriers to trade in the form of quantitative restrictions.<sup>304</sup> VERs thus violate Article XI of GATT.<sup>305</sup>

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<sup>300</sup> See Chapter 1.

<sup>301</sup> See examples under: 1. Chapter, 4. Why Do Exporters Agree to VERs.

<sup>302</sup> Michel Kostecki, *supra*, note 25 at 441: VERs as a substitute for import restrictions.

<sup>303</sup> Peter Wong, *supra*, note 62 at 303.

<sup>304</sup> Edmond McGovern, *supra*, note 89 at 187.

<sup>305</sup> Ernst-Ulrich Petersmann, *supra*, note 105 at 31.

The general prohibition of Article XI has some exceptions. Article XII allows for the use of quantitative restrictions in the case of balance-of-payments difficulties.<sup>306</sup> However, neither of the two types of balance-of-payments difficulties described in Article XII 2(a) is applicable to VERs. VERs do not aim to counterbalance decreases of monetary reserves. It is also argued that the measures described under subsection 2(a) are related to import controls and therefore do not apply to VERs.<sup>307</sup> Measures taken to restrict the Balance of Payments cannot be perpetually renewed.<sup>308</sup> They have to be progressively relaxed (subsection 2(b)). VERs are continuously renewed.

Other exceptions are included in Article XI itself. Paragraph 2(a) is the only exemption eligible for the use of VERs. It allows the application of export restrictions "to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party." The purpose of this exception is to guarantee the supply of goods in the importing country. A "critical shortage" relates to cases of "considerable rise in prices due to a rise in prices abroad", an especially relevant provision for seasonal food.<sup>309</sup> VERs are not taken because the exporting country fears a "critical shortage", but because too many exports are likely to cause import restrictions by the importing country. VERs are concluded in the interest of the importing country, not of the exporting country.

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<sup>306</sup> Kenneth W. Dam, *supra*, note 45 at 151.

<sup>307</sup> Malcolm Smith, *supra*, note 53 at 29.

<sup>308</sup> Peter Wong, *supra*, note 62 at 303.

<sup>309</sup> GATT, B.I.S.D. 3d Supplement 170 at 191 (1955)

As a conclusion, the following can be said: VERs can be characterized either as a form of export or of import restriction under Article XI. Both possibilities violate Article XI of GATT.<sup>310</sup> There is no exception available to justify the application of VERs.

### 3. Safeguard Clause

Article XIX of GATT allows the member countries to impose import restrictions under carefully defined circumstances, or to suspend tariff concessions against products which are being imported in such increased quantities and under such conditions as to cause or threaten to cause serious injury to domestic producers of like or directly competitive products.<sup>311</sup> Protection under the safeguard provision may be received "to the extent and for such time as may be necessary to prevent or remedy such injury."

Article XIX requires that three further conditions be observed: First, the importing country must inform the exporting country of its intention to take an emergency action according to Article XIX(2).<sup>312</sup> Second, the importing country must pay compensation to the exporting countries for the loss sustained by them through the quota restriction. Third, the GATT principle of non-discrimination must be observed.<sup>313</sup>

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<sup>310</sup> Reinhard Quick, *supra*, note 16 at 267.

<sup>311</sup> See John H. Jackson, *supra*, note 8 at chapter 23.

<sup>312</sup> Peter Wong, *supra*, note 62 at 307.

<sup>313</sup> A. J. Sarna, *supra*, note 35 at 357.

The reason for introducing Article XIX into GATT was to stop unilateral protectionist actions, by making them dependent on certain conditions and putting them under the surveillance of all member states.<sup>314</sup> The so-called safeguard or escape clause provides for a non-discriminatory treatment of all states even if the principle of non-discrimination is not expressly mentioned in Article XIX. The framework of GATT is based on the principle of non-discrimination. Unless otherwise mentioned in the provision, safeguard protection must be applied on a Most-Favoured-Nation basis and not on a selective basis against only some countries.<sup>315</sup> Selectivity does not find support in GATT.

VERs which are negotiated between only two countries are incompatible with Article XIX.<sup>316</sup> The economic argument that VERs are less restrictive than quotas under Article XIX has never been proven. VERs involve only one exporting country, which especially disturbs the market of the importing country. Article XIX may also ultimately only be directed against some particular countries. Furthermore, one country may have VERs on one and the same product with many different countries.

Importing countries do not have to inform third countries about their VERs. VERs are most often concluded

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<sup>314</sup> Victoria Curzon Price, *supra*, note 22 at 312.

<sup>315</sup> During the Tokyo Round, the Nordic countries declared that nowhere in Article XIX is it stated that protection has to be applied in a non-discriminatory way, therefore no revision of the provision was considered necessary to introduce selective measures, see Brian Hindley, *supra*, note 24 at 354.

<sup>316</sup> Thomas Sauermilch, "Market Safeguards Against Import Competition: Article XIX of the General Agreement on Tariffs and Trade" (1982) 14 *Case Western Reserve Journal of International Law* 83.

secretly without any official document. They do not require a procedure such as described under Article XIX.<sup>317</sup> By applying VERs instead of the safeguard provision, GATT member states circumvent the requirements of Article XIX of GATT.<sup>318</sup> Member countries that do not apply the safeguard clause which they once agreed to, clearly violate their obligations under GATT.<sup>319</sup>

To justify their behavior, the states like to point towards the MFA as a legal basis for VERs. The MFA however, as it has already been pointed out, only relates to trade in textiles. Provisions of this agreement cannot be transferred to other sectors.

The GATT has not been changed by the MFA. The textile sector has only been taken out of the framework of GATT and given its own special provisions. They are only applicable within the textile and clothing sector and not beyond it. VERs other than in the textile field are not justifiable by Article 4 of the MFA.<sup>320</sup> States which try to institutionalize VERs as acceptable forms of trade protection violate GATT rules.<sup>321</sup>

Perhaps Article XIX today is inadequate in responding immediately and effectively to sudden increases in

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<sup>317</sup> Kenneth W. Dam, *supra*, note 45 at 102.

<sup>318</sup> Ernst-Ulrich Petersmann, *supra*, note 105 at 31.

<sup>319</sup> Peter Wong, *supra*, note 62 at 309.

<sup>320</sup> UNCTAD, *supra*, note 15 at 4.

<sup>321</sup> *Ibid.*

imports.<sup>322</sup> Nevertheless it is still the valid procedure for safeguard protection.

#### 4. Tokyo Round

The Tokyo Round of Multilateral Trade Negotiations was opened in September 1973 at a Ministerial Meeting in Tokyo. In their declaration,<sup>323</sup> the Ministers underlined that the negotiations should aim, inter alia, to:

- reduce or eliminate non-tariff measures or, where this is not appropriate, to reduce or eliminate their trade-restricting or distorting effects and to bring such measures under more effective international discipline;
- include an examination of the adequacy of the multilateral safeguard system, considering particularly the modalities of the application of Article XIX, with a view to furthering trade liberalization and preserving its results.

The Tokyo Round negotiations focused on manifold non-tariff measures. It differed in this regard from previous GATT Rounds, which have been mostly concerned with tariffs. Ninety-nine countries took part in the negotiations, both member and non-member countries of GATT. More than two thirds of them were developing countries.

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<sup>322</sup> Among others, Jan Tumlin, "Emergency Protection against Sharp Increases in Imports" in Hugh Corbett and Robert Jackson, *In Search of a New World Economic Order* (London: Trade Policy Research Center, 1974) and David Robertson, *Fail Safe Systems for Trade Liberalization* (London: Trade Policy Research Center, 1977).

<sup>323</sup> It became known as the Tokyo Declaration.

#### a. Non-Tariff Measures

The expectations for the outcome of the multilateral negotiations of non-tariff barriers were high, but the member states had very little experience in negotiating on these measures.<sup>324</sup> Approximately thirty different non-tariff measures were distinguished. The most common measures were put together under a list of priorities in 1973.<sup>325</sup> During the Tokyo Round the attention was mostly drawn to this priority list, which covered:

- export subsidies and domestic subsidies that distort trade
- anti-dumping and countervailing duty
- government procurement
- valuation for customs purposes
- standards, including packaging and labelling
- quantitative restrictions, including embargoes and export restraints and licensing systems
- import documentation and consumer formalities

During the Tokyo Round, agreements could be negotiated for subsidies and countervailing duties; technical barriers to trade; customs valuation; government procurement and import licensing procedures.<sup>326</sup> Other issues under the category of quantitative restrictions, including VERs, remained open. In March 1975 a Sub-Group was set up for this category of trade negotiations.<sup>327</sup>

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<sup>324</sup> GATT, *The Tokyo Round*, supra, note 10 at 49.

<sup>325</sup> *Ibid.* at 51.

<sup>326</sup> For a discussion of some of the agreements reached during the Tokyo Round see John Quinn and Philipp Slayton, eds., *Non-Tariff Barriers After the Tokyo Round* (Montréal: Institute for Research on Public Policy, 1982).

<sup>327</sup> GATT, *The Tokyo Round*, supra note 10 at 85.

At the end of the Tokyo Round it was clear that no substantive negotiations on quantitative restrictions had been reached. The Subgroup did not touch the issue of VERs. The Tokyo Round did not bring any results for the elimination or reduction of VERs.<sup>328</sup>

b. Safeguard System

The question of the adequacy of the multilateral safeguard system was one of the key issues in the Tokyo Round. Most of the industrialized countries wished to improve the GATT safeguard provisions.<sup>329</sup> The states pointed out that without satisfactory safeguard measures, they would not be inclined to move towards further trade liberalization.<sup>330</sup>

The reluctance of the states to take non-discriminatory safeguard actions, brought up the question of whether or not safeguard protection should be based on a selective basis as between two countries.<sup>331</sup> Selectivity became the main point of discussion. The developing countries opposed the idea of any change of Article XIX that would permit the developed countries to take emergency actions on a selective basis. They knew that the new protectionist possibility would turn against their exports.

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<sup>328</sup> *Ibid.* at 85-87.

<sup>329</sup> *Ibid.* at 91.

<sup>330</sup> Brian Hindley, *supra*, note 24 at 316: The reason is that imports injuring domestic industries produce high social costs (unemployment) and political tension (pressure from the powerful industries).

<sup>331</sup> GATT, *The Tokyo Round*, *supra*, note 10 at 94.

Negotiations for a revised safeguard clause did not begin until the end of the Tokyo Round. The reason for the postponement was the desire of the states not to start safeguard negotiations before trade liberalization had further advanced.<sup>332</sup> The Tokyo Round did not bring a solution to safeguard protection. A committee was established within GATT to continue on this issue. Negotiations on a multilateral safeguard system have been resumed in the Uruguay Round. Non-tariff measures are again a main topic in Uruguay.

## 5. Uruguay Round

On September 20, 1986 the most complex trade round under the auspices of GATT was launched in Punta del Este, Uruguay.<sup>333</sup> Multilateral trade negotiations have been divided into fifteen different areas and are expected to last four years. The negotiations in the Uruguay Round are conducted in two separate sections. The first section deals with negotiations on trade in goods, the second one with negotiations on trade in services. The negotiation plan for the Group of Negotiations on Goods provides for a "standstill" on new trade measures incompatible with GATT and a "rollback" programme for the elimination of all existing inconsistent trade barriers.<sup>334</sup>

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<sup>332</sup> *Ibid.* at 92.

<sup>333</sup> See GATT, Ministerial Declaration on the Uruguay Round, September 20, 1986, reproduced in GATT, B.I.S.D. 33th Supplement (Geneva: The Contracting Parties, June 1987).

<sup>334</sup> *Ibid.* at Section C.

### a. Non-Tariff Measures

An objective is to eliminate all "grey area" measures. One proposal suggested that in the future bilateral negotiations should be held under multilateral scrutiny to guarantee non-discriminatory treatment. Another proposal, to separate the measures into those consistent and those inconsistent with GATT, was held to be difficult and time consuming. The question of GATT consistency was finally postponed until the end of negotiations. It is not to be expected that the Uruguay Round will give an answer as to whether VERs are consistent or inconsistent with GATT.

After the first year of the Uruguay Round, the Chairman of the Trade Negotiations Committee and Foreign Minister of Uruguay, Mr. Enrique Iglesias, pointed out that "in the context of the 'standstill' commitment, the dangerous tendencies in international trade policies - which were very much at the root of our determination to launch a new round of trade negotiations - have shown no real sign of abating in the past twelve months. On the contrary, damaging trade disputes have continued, especially among the major industrial countries, and protectionist pressures on governments in some of those same countries have perhaps even worsened. It is a sad observation that, at a time when a great opportunity exists to expand trade to the benefit of all through the reinforcement and extension of the multilateral trading system, so much effort is being expended and uncertainty created in the battle against those who would willingly repeat the catastrophic mistakes of the past."<sup>335</sup>

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<sup>335</sup> GATT, Focus (Newsletter) No.51 from January 1988 at 3.

## b. Safeguard System

The safeguard discussion centered around the debate of whether or not safeguard agreements should be based upon the principle of non-discrimination. Some countries suggested that Article XIX action should continue to be taken on a non-discriminatory basis. One proposal suggested that developed countries should not apply safeguard protection against imports from developing countries. It was further suggested that the duration of safeguard measures should be limited to no more than three years or in exceptional cases up to five years. The average duration of an emergency action under Article XIX today is just over three years.<sup>336</sup>

It was proposed to begin with examination of the language of Article XIX, like the determination of "serious injury or threat thereof." On March 9, 1988, the states began to discuss how the existence of "serious injury or threat thereof" should be defined. They agreed that concrete objective criteria should be used in order to avoid subjective opinions of the states. The provision should be clear, transparent and stringent.

Increased transparency and notification were required by some Pacific countries, as well as the option of compensation for developing countries. The question of compensation was treated on July 14-15 once again.<sup>337</sup> It was argued that those states which did not wish to pay compensation would take "grey area" measures instead. Furthermore, a multilateral surveillance body on safeguards was proposed, along with a safeguards committee, to

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<sup>336</sup> News of the Uruguay Round, NUR 005 from July 3, 1988 at 2-3.

<sup>337</sup> News of the Uruguay Round, NUR 018 from August 2 1988 at 8.

supervise safeguard actions.<sup>338</sup> Only a surveillance system with fixed rules and procedures can guarantee that protectionist measures are not taken unilaterally again and again outside the scope of GATT.<sup>339</sup>

### c. Textile and Clothing

The textile and clothing sector is one of the most important topics in the Uruguay Round. Many of the member countries wish to dismantle the MFA and reintegrate it into the GATT. The textile and clothing sector has been subject to restrictions outside the GATT for a long time now. The latest extension of the MFA to the end of the present decade illustrates the permanent feature of this international agreement. It will be difficult to break from this agreement in the Uruguay Round. The developed countries in particular wish to keep the MFA. The developing countries oppose the MFA more and more, because their access to the markets of the developed countries is increasingly restrained.

Delegates examine the "techniques and modalities" which would permit the integration of the textile and clothing sector into the GATT framework.<sup>340</sup> Recommendations come from the developing countries, which would like to abolish the principle of market disruption established under the MFA to protect the industries in the developed countries. The proposals include a multiple process to dismantle the MFA.

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<sup>338</sup> News of the Uruguay Round, NUR 015 from March 31, 1988 at 4-5. News of the Uruguay Round, NUR 017 from June 30, 1988 at 2-3.

<sup>339</sup> See Oliver Long, *supra*, note 132 at 258.

<sup>340</sup> News of the Uruguay Round, NUR 015 from March 31, 1988 at 6-7.

First, all concepts and practices under the MFA which are incompatible with GATT should be eliminated. Second, the GATT principles relating to trade in textiles among developing countries must be applied more effectively. Third, the MFA and all associated bilateral agreements shall be terminated.

Most of the developed countries are worried about the consequences for their economies. The world textile trade without the quota system under the MFA would be much greater and liberalized. At a Ministerial Round Table on November 30, 1987, Minister Mahbub Ul Haq of Pakistan, asked if he was confident that developing countries would be better off without the MFA, said: "The whole world would be better off. Comparative advantage would prevail, so that the low cost countries and producers of raw materials such as cotton would be the textile centers of the world, not the centers which have developed under artificial quotas."<sup>341</sup>

#### 6. Mid-Term Ministerial Meeting in Montréal

The Mid-Term Ministerial Meeting in Montréal from 5 to 9 December 1989, was characterized by substantial progress on many issues.<sup>342</sup> Some 90 Ministers of trade, economy, industry and agriculture and about one thousand representatives of all the countries participating in the Uruguay Round reached agreements on 11 of the 15 different subjects.<sup>343</sup> However, in areas such as agriculture,

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<sup>341</sup> GATT, Focus (Newsletter) No.51 from January 1988 at 5.

<sup>342</sup> GATT, Focus (Newsletter) No.59 from January 1989 at 1.

<sup>343</sup> Trade Negotiations Committee Meeting at Ministerial Level in Montréal, GATT MTN.TNC/7 (MIN) from December 9, 1988.

textiles, reform of the safeguard system and trade-related intellectual property, no agreement could be reached.<sup>344</sup>

The Ministers agreed that the goal of the round should be a substantial reduction or elimination of NTBs. Whenever possible, NTBs should be changed to tariffs if they cannot be eliminated. Negotiators agreed to create a framework for future talks by June 1989.<sup>345</sup>

On December 9, it was decided to suspend all results reached in the Mid-Term Meeting until April 1989. This will give the negotiators five months to reconsider their position.<sup>346</sup>

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<sup>344</sup> The Uruguay negotiators agreed to focus on the four main issues, *International Trade Reporter*: January 25, 1989, Vol.6, No.4 at 102.

<sup>345</sup> *International Trade Reporter*: December 14, 1988, Vol.5, No.49 at 1619.

<sup>346</sup> *Ibid.* at 1617.

#### 4. CHAPTER: THE FUTURE ROLE OF VER AGREEMENTS

##### 1. Recent Development in the Uruguay Round

Today, more than thirty years after the revival of VERs, these measures are still an important element of the trade relations of states. After the failure of the Tokyo Round to resolve problems caused by VERs, the Uruguay Round again opens the likelihood of the states agreeing on a reduction or elimination of VERs. So far, the member states agreed to "tariffy" VERs.<sup>347</sup>

Converting VERs into tariffs is favored by many economists.<sup>348</sup> As it was shown in the first chapter of this study, tariffs are preferable to import quotas or VERs for at least three reasons: First, quotas freeze the markets and therefore hinder competition. Second, import quotas and VERs raise the prices of the restricted products. For the consumer, the additional cost is like a hidden tax whose origin does not become transparent. Third, money collected through tariffs goes to the government of the importing state, whereas VERs give profits to the foreign exporter.

The plan to convert VERs into tariffs only covers VERs that are currently in force. The GATT member states have not yet agreed to ban VERs, nor how to prevent such measures in the future. During the Uruguay Round, there has not even been agreement between the states as to whether or not VERs were conflicting with GATT.

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<sup>347</sup> GATT, Focus (Newsletter) No.59 from January 1989 at 2: It was agreed to transform non-tariff barriers into tariffs.

<sup>348</sup> Karen Pennar, "The Gospel of Free Trade is Losing Apostles" Commentary in BusinessWeek from February 27, 1989 at 89.

GATT member states negotiated VERs during the Uruguay Round, despite the "standstill" commitment in GATT. In the Ministerial Declaration of 1986, each state agreed "(i) not take any trade restrictive or distorsive measure inconsistent with the provisions of the General Agreement or the Instruments negotiated within the framework of GATT under its auspices."<sup>349</sup>

Immediately after the Uruguay Declaration, the former United States Trade Representative, Mr. Clayton Yeutter,<sup>350</sup> announced that the "standstill" commitment did not apply to "grey area" measures.<sup>351</sup> According to Mr. Yeutter's statement, VERs do not belong to the category of trade measures inconsistent with the General Agreement.

## 2. Coverage of VER Agreements by GATT

VERs are not only in contradiction to GATT provisions, but they also undermine the role of GATT as a trading system.<sup>352</sup> The functioning and the efficiency of GATT as a forum for multilateral trade negotiations is endangered if its member states have recourse to bilateral agreements. In the Uruguay Round, the member countries are trying to improve the GATT system in different ways. It was agreed

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<sup>349</sup> The Standstill Commitment is included under Section C of Part I of the Uruguay Declaration, reproduced in GATT, B.I.S.D., 33d Supplement (Geneva, The Contracting Parties, June 1987).

<sup>350</sup> Now secretary of agriculture under the Bush Administration.

<sup>351</sup> Brian Hindley, "GATT Safeguards and Voluntary Export Restraints: What Are the Interests of Developing Countries?" (1987) The World Bank Economic Review, Vol.1 No.4 689 at 672.

<sup>352</sup> Martin Wolf, *supra*, note 12 at 5.

that the trade policies of the member countries should become more transparent, that annual trade reports should be filed and that the trade policies of the member states should be open to regular reviews.<sup>353</sup>

Many proposals have been made during the last fifteen years as to how VERS could be removed from international trade.<sup>354</sup> Two major solutions are considered: The first proposes that VERS be prohibited expressly by a GATT provision, so that governments are no longer allowed to apply such measures.<sup>355</sup> The second possibility would be to modify the safeguard clause in a way which would make states more inclined to use it to protect their economies.<sup>356</sup> These options are discussed in the following sections.

#### a. Prohibition of VER Agreements

Today, there exists no agreement which prohibits the use of VERS. In the Uruguay Round, there has not been an approach towards the formulation of such a provision. It is doubtful that there will be such an agreement in the near future. No member state will propose a prohibition of VERS unless it finds them disadvantageous. For the reasons described in the first Chapter, most states engaging in VERS have little interest in changing the current practice.

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<sup>353</sup> GATT, Focus (Newsletter) No.53 from February/March 1988 at 5. These proposals were made in the negotiation group on the Functioning of GATT.

<sup>354</sup> Jan Tumlr, *supra*, note 42 at 404; Alasdair I. MacBean, *supra*, note 33; Ernst-Ulrich Petersmann, *supra*, note 105.

<sup>355</sup> Suggested for example by Michel Kostecki, *supra*, note 25 at 440.

<sup>356</sup> For example Reinhard Quick, *supra*, note 16 at 282.

Developing countries are most likely to initiate such changes.<sup>357</sup> VERs are considered to be most disadvantageous for them because they limit the market access of products that typically represent a significant portion of these countries' foreign trade. However, no developing country has taken a significant initiative in the GATT negotiations to prohibit the establishment of new VERs.

Because of the lack of interest of the GATT member states in the prohibition of VERs, a possible solution to the conflicts caused by VERs would be a change in the safeguard clause that addresses the protectionist needs of industrialized states as well as the interests of developing countries.

#### b. Change of the Safeguard Clause

In order to eliminate "grey area" safeguard measures, there are two possible ways to change Article XIX. The possibilities of safeguard measures allowed under Article XIX GATT should be restricted or broadened.<sup>358</sup>

##### 1) Restricting the Safeguard Clause

A more restricted Article XIX could make safeguard protection less favourable and less available for importers.<sup>359</sup> Therefore, many developing countries would refuse to negotiate VERs and refer developed countries to

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<sup>357</sup> VERs are especially opposed by developing countries, see Peter Wong, *supra*, note 62 at 308.

<sup>358</sup> Jan Tumliir, *supra*, note 322 at 269 ff. He calls it the 'hardest' and the 'softest' version.

<sup>359</sup> Brian Hindley, *supra*, note 24 at 332.

the application of Article XIX. However, if an Article XIX protection is not granted, developed states would be likely to initiate the negotiation of VERs or would threaten exporters with unilateral protectionist measures. Therefore, a more restrictive Article XIX would favour VERs rather than prevent them.<sup>360</sup>

## 2) Broadening the Safeguard Clause

Article XIX could be broadened in such a way as to make the importing country less inclined to use VERs.<sup>361</sup> The requirements of safeguard measures could be weakened. This would make it easier for a country to seek protection against foreign imports within the rules of GATT, without having to apply any "grey area" measures.<sup>362</sup>

Broadening the safeguard clause is one of the most promising GATT measures to reduce VERs. The requirements for non-discriminatory safeguard measures could be weakened without major conflicts with GATT principles. However, broadening Article XIX too much would be against GATT's interest in promoting free trade because it would make it too easy for member states to establish protectionist barriers.<sup>363</sup> If Article XIX is to be changed, a good

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<sup>360</sup> Jan Tumlr, *supra*, note 322 at 271: He finds the 'hard' measure particularly unpromising as an instrument for coping with VERs.

<sup>361</sup> Brian Hindley, *supra*, note 24 at 333.

<sup>362</sup> It is often suggested to bring VERs under Article XIX, rather than to have them outside the scope of GATT, see in this respect, Victoria Curzon Price, *supra*, note 22 at 309 and Misao Tatsuta, *supra*, note 69 at 331.

<sup>363</sup> Brian Hindley, *supra*, note 24 at 338; Jan Tumlr, *supra*, note 322 at 272.

balance between addressing safeguard needs and preventing unnecessary protectionism has to be found. Therefore the conditions of new safeguard clause regulations have to be carefully defined. Tumlrir and Petersmann have laid out detailed requirements for changes in the safeguard clause.<sup>364</sup>

### 3) Allowing Selective Safeguard Measures

The principle of non-discrimination is one of the fundamental rules of GATT. It was introduced to protect smaller and weaker countries against abuse of power by the developed countries.<sup>365</sup>

GATT member countries are currently discussing whether a selective application of the safeguard clause should be allowed. The demand for selective safeguard measures came up during the Tokyo Round and is once again being discussed in the Uruguay Round.<sup>366</sup>

Changes in Article XIX could allow the negotiation of bilateral safeguard agreements between member countries. Such changes would very likely reduce the use of VERs because they would address the needs of states to protect themselves against specific exporters.<sup>367</sup> One of the major reasons why VERs are used today is that all safeguard measures allowed by GATT have to be applied on a non-discriminatory basis.

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<sup>364</sup> Ernst-Ulrich Petersmann, *supra*, note 105 at 37; Jan Tumlrir, *supra*, note 42 at 412.

<sup>365</sup> Victoria Curzon Price, *supra*, note 22 at 312.

<sup>366</sup> GATT, *The Tokyo Round*, *supra*, note 10 at 94.

<sup>367</sup> Brian Hindley, *supra*, note 24 at 315.

There are several arguments for allowing selective safeguard measures within Article XIX. It is believed that bilateral agreements have less impact on world trade than global quotas. The European Communities favoured selectivity already during the Tokyo Round.<sup>368</sup> They considered non-discrimination to be an unnecessary element, when injury is only caused by a few countries.

A reform of Article XIX towards selectivity would eliminate "grey area" measures because there would be no reasons for governments to seek protection outside GATT. However, to bring VERs under Article XIX would contradict the principle of non-discrimination.<sup>369</sup> Therefore, allowing selective safeguard protection would be a violation of GATT principles. This would actually correspond to legalizing VERs. Therefore it is unlikely that GATT will allow significant selective safeguard measures in the future.

### 3. Free Trade or "Managed" Trade

When the GATT member states signed GATT they agreed to the principles of free trade. After the Great Depression and World War II, free trade was supposed to bring the greatest economic benefits to all nations. Through comparative advantage - countries do what they do best and they trade the goods that result - goods would be distributed to all trade partners in a perfectly competitive world. It guarantees efficient allocation of resources, competition and stability of prices.

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<sup>368</sup> Victoria Curzon Price, *supra*, note 22 at 310-311.

<sup>369</sup> See discussion in the third Chapter.

Today, free trade and comparative advantage are no longer the guiding principles of all countries.<sup>370</sup> The nations try to restrict international competition and therefore deny comparative advantage.

VERs are an excellent example of opposition to free trade and comparative advantage by countries. The purpose of VERs is to counterbalance comparative advantage by establishing quotas. They share markets between countries instead of letting comparative advantage prevail.<sup>371</sup> The trend in world trade away from comparative advantage towards market sharing agreements is the result of more and more competition in world trade.<sup>372</sup> It is the result of a growing industrialization in Third World countries.

Without protection, some industrialized countries will be forced to give up industries or manufacturing sectors that they were leading for many years. Newly industrialized countries (NIC) such as South Korea, Singapore and Taiwan will become the major manufacturing nations.

For many developed nations, the question arises whether it is in the best interest of the nation to follow the principles of free trade.<sup>373</sup> Laura D'Andrea Tyson, an economist from the University of California at Berkeley said in a recent interview: "We should be thinking about using trade policies to promote and protect industries and technologies that we believe to be important to our well-

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<sup>370</sup> Karen Pennar, *supra*, note 348 at 89.

<sup>371</sup> They are therefore often given the name of market-sharing agreements.

<sup>372</sup> OECD, *Competition and Trade Policies [:] Their Interaction* (Paris: OECD, 1984).

<sup>373</sup> As quoted by Karen Pennar, *supra*, note 348 at 89.

being."<sup>374</sup> Many economists feel like Laura Tyson. They would like to see the principal of free trade corrected into "strategic" or "managed" trade.<sup>375</sup> Managing trade, they believe, is the only way to guarantee certain market shares in important industries. However, "managing" of trade means that governments will intervene in the market process.

Interventionism is contrary to the principle of free trade as laid down by GATT. Free trade is usually characterized by a "laissez faire" policy of the states. Supply and demand are the only determining factors of the market. The GATT member states are only allowed to intervene in the market process under special circumstances, for example in balance of payments difficulties.

VERs are "managed" trade. The two governments concerned regulate the commerce in a particular sector between each other. VERs are inconsistent with the spirit of GATT, because they replace free trade by "managed" trade.

#### 4. Other Considerations

There are many other factors that will determine the future role of VERs in world trade. Their thorough investigation is beyond the scope of this thesis. They are shortly addressed in the following sections and could be the basis of future work concerning VERs and world trade in general.

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<sup>374</sup> *Ibid.*

<sup>375</sup> Lester C. Thurow, Dean of the Sloan School of Management at the Massachusetts Institute of Technology, *Ibid.*

### a. Against Free Trade

In a world with perfectly free trade, many economic and political problems would arise. Due to the lower wages in the developing countries, many manufacturing industries in developed countries would be seriously endangered.

Free trade would lead to the shift of manufacturing sectors from industrialized to developing countries. This would result in a higher interdependence of all countries. This is not desirable for many developed countries for strategic reasons. A dependence on manufactured goods from developing countries is worse than just depending on natural resources.

The influence of free trade on domestic politics plays a very important role. Protectionist measures tend to have a positive short-term influence on employment. Many countries have significant traditions associated with certain industrial sectors. They are reluctant to abandon such sectors in favour of imports. Also, domestic industrial pressure groups can have a very strong influence on governments in initiating protectionist measures in order to reduce competition.

### b. In Favour of Free Trade

Protectionist measures result in higher costs of goods for consumers. Due to the internationalization of the societies in industrialized countries, consumers will gain more and more influence favouring free trade.

The economic costs of protectionist measures are often very high. In most cases they do not stand in a rational relationship to the achieved protection. Quotas, for

example, freeze the markets; only a limited number of products may be imported. The effect is that prices increase and the availability of products decreases. The economic burden does not only lie on the consumer but on the economy of the restricting state as a whole. The protection of unprotective industries can have for consequence reduced levels of real income and reduced rates of economic growth.

Protectionist measures lead to a subdivision of the world's markets, mostly among industrialized nations. This leads to reduced competition, a stagnation in world trade and a limit to the opportunities for economic growth. Under these circumstances, protectionism is most disadvantageous to developing countries.

#### c. Influence on VER Agreements

The general tendencies in world trade have a significant influence on the role of VERs in the future. Any tendencies that promote free trade will reduce the need for VERs. Protectionist trends will favour the establishment of new VERs as long as the need for bilateral safeguard measures prevails.

#### 5. Conclusion

VERs are likely to continue to play an important role in world trade. They are widely accepted as part of the status quo by most of GATT member states. From the point of view of the states, they are the best alternative to an inadequate GATT safeguard clause. However, they represent a movement away from the principles of free trade towards a bilateral regulated international trade. They are a threat to the GATT system which is based on free trade.

The structural problems in certain trade sectors still exist. As long as these sectors are not competitive in world trade and the states do not find an alternative safeguard measure, VERs will continue to be used.

Changes in GATT could make VERs obsolete in the near future. The crucial point is whether or not the principle of non-discrimination should prevail or be replaced by selectivity. In particular the developed states seem to prefer selective safeguard measures such as VERs. A future safeguard clause would therefore have to provide the option of negotiating other agreements similar to VERs within the scope of GATT.

In the long term, an overall shift towards more free trade among the nations could reduce the need for VERs. Today, there is no indication for such a shift.

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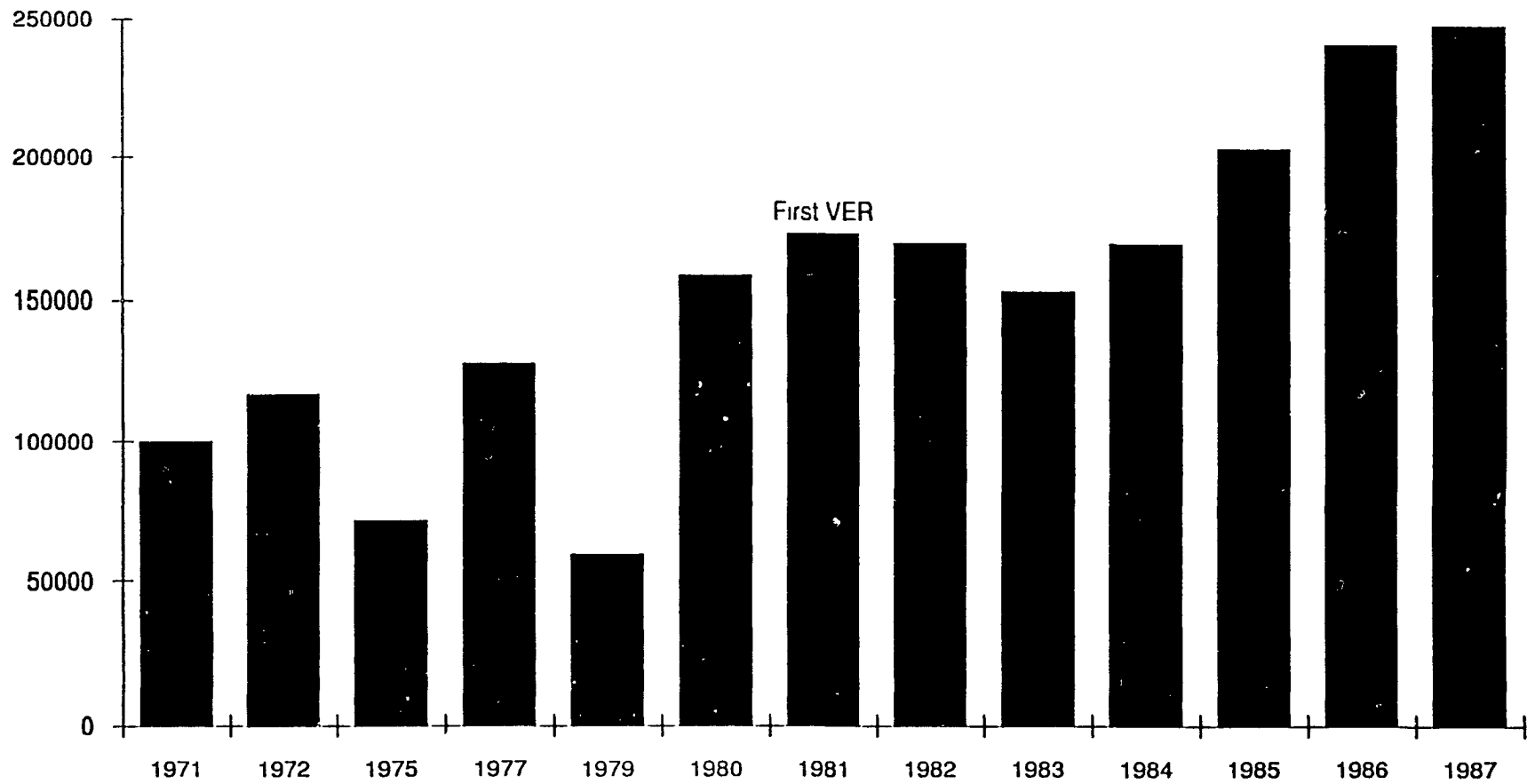
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Number of passenger cars exported by Japan to Canada



Source: Keith A. Hay and S. R. Hill, Canada Japan: The Export-Import Picture, Chart 24 and Japanese Automobile Association.