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GLOBAL ECONOMIC CRISIS AND THE DANGER OF PROTECTIONISM: DOES INTERNATIONAL LAW HELP?

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"I think it would be a mistake … for us to start sending a message that somehow we're just looking after ourselves and not concerned with world trade."

Barack Obama, President of the United States of America,
Interview with Fox News, 3 February 2009

Introduction

The current economic crisis has assumed truly global proportions. Having its origins in the financial market of the United States, it has spread around the world like a bush fire, with most countries now heading into economic recession and volumes of international trade and investment contracting fast. It is predicted that by the end of 2009 world trade flows will have fallen by roughly 9 per cent – the biggest drop in more than 60 years.

The financial crisis has had a devastating effect on the banking system, a major pillar of a healthy economy. The resulting liquidity shortages have impacted the real economy; consumer demand, confidence and investment are shrinking everywhere, while unemployment is growing. These extraordinary circumstances have called for increased public intervention in markets. Most governments have been taking urgent measures to stabilise the banking system, through bail-outs and nationalisations, so that the banks could resume their role of providing liquidity and supporting investment in the real economy. Governments have also been providing support to specific industries, especially those dependent on consumer credit, in particular automobile manufacturers.

An economic downturn increases the probability of states resorting to protectionist policies that would favour domestic producers of goods and services. Politicians, faced with increased domestic pressure from trade unions and industry lobbies, may feel that their first priority is to tame the recession in their respective countries, support local industries and slow down local unemployment at all costs.

Economic history reveals the dangers of economic isolationism, which may be politically attractive in the short term, but globally harmful in the long

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term. Economists blame it for the troubles of the 1930s: they believe that it was the tit-for-tat protectionism that turned what started out as a recession into the Great Depression. The 1930 Smoot-Hawley Act raised US tariffs on more than 1,000 foreign products by an average of 20 per cent. After that, the British Parliament passed the Abnormal Importation Act (1931) and the Import Duties Act (1932). These actions led to widespread worldwide escalations of trade barriers – "in 1935, every country in Europe was using almost every known method of trade restriction"[1] – and contributed to the 30 per cent reduction in world export and import volume.[2]

Today, major economies have publicly condemned protectionism. In the declaration resulting from the G-20 meeting in Washington DC (November 2008), the heads of State "underscore[d] the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty" and promised to refrain from protectionist measures for the following 12 months.[3] This has not prevented several countries, including 17 of the G-20, to implement at least 47 trade-restrictive measures, which have included tariff increases, import licensing requirements, domestic sourcing provisions, restricted entry, tightening of standards, and even outright import bans on particular products.[4] Various countries including Canada, China, France, Germany, United Kingdom, Sweden, the United States and others have been granting state aid to particular industries, notably the automobile industry that has received a total of some US$ 48 billion worldwide.[5] While it is suggested that so far the negative impact of these trade-restrictive measures has been relatively minor (the drop in trade is being attributed primarily to the rapid contraction of credit necessary to finance export and import operations, decline in asset prices, weakened demand and decreased production), they constitute a dangerous trend.

The state of international economic law today is markedly different from that of the 1930s. The conclusion of the General Agreement on Tariffs and Trade (GATT) in 1947, which later grew into the World Trade Organisation, is one major change. But there has also been a great development in international investment law with more than 2,600 investment treaties concluded. The European Union, a close economic and political block of 27 countries, has a

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[1] P. Friedman, *The Impact of Trade Destruction on National Incomes*, Gainesville: The University Presses of Florida 1974, p. 31.
[2] For details, see J.B. Madsen, 'Trade Barriers and the Collapse of World Trade during Great Depression', *Southern Economic Journal* (67) 2001, p. 848.
[3] This commitment was reaffirmed in the latest G-20 Communiqué of 2 April 2009, with the pledge extended to the end of 2010.
[4] For details, see World Bank, 'Trade Protection: Incipient but Worrisome Trends', Trade Note #37, 2 March 2009, available at http://siteresources.worldbank.org/NEWS/Resources/Trade_Note_37.pdf (accessed on 26 March 2009). A fuller and more up-to-date list can be found in: WTO, 'Report to the Trade Policy Review Body by the Director-General on the Financial and Economic Crisis and Trade-Related Developments' (Annex 1), 26 March 2009, available at www.wto.org.
[5] *Idem*, p. 4.

single market and a developed legal system of its own. The question is whether, and in how far, these legal structures can prevent economic nationalism and beggar-thy-neighbour policies in the current situation.

I. WTO Framework

The World Trade Organization (WTO) is a multilateral institution whose very *raison d'être* is the prevention of protectionism in international economic relations. In the words of its Director-General, Pascal Lamy, the WTO serves as an "insurance policy" against protectionism. Indeed, the WTO's objective is to create a level-playing field and ensure that goods from different countries enjoy equal competitive opportunities. To achieve this, WTO members[6] have been gradually phasing out – through several rounds of multilateral negotiations – tariff and non-tariff barriers to trade in goods and services. Even though many barriers persist, especially in agricultural trade, the WTO has been relatively successful in significantly lowering (e.g., tariffs) or even completely eliminating (e.g., quantitative restrictions) them.

The relevance of the WTO framework can be judged by the fact that the crisis response by non-member countries has been markedly different from that of WTO members. Thus, Russia, the only major economy outside the WTO, swiftly introduced 28 measures to raise import tariffs arguing that they were necessary to help Russian companies survive the crisis. WTO members are prevented from doing the same by the general WTO prohibition on tariff increases. (It must be borne in mind, however, that when the tariffs *actually applied* by WTO members are *below* their committed levels, there is headroom for raising tariffs without violating WTO rules.)

Perhaps the most controversial measure introduced by a WTO member so far was the so-called "Buy American" provision, an integral part of the US$ 787 billion economic stimulus legislation adopted by the United States. The "Buy American" rule requires, with some exceptions, the purchase of US-made iron and steel in certain public works projects funded by the stimulus package. Its objective is clearly to support domestic iron and steel manufactures by requiring purchasers to buy their produce regardless of the price and other factors.[7]

Despite its protectionist nature, the "Buy American" clause does not fall within the *multilateral* WTO framework as it relates to public procurement, which is regulated in a *plurilateral* WTO agreement signed only by some, but not all, WTO members. Disciplines prohibiting discrimination in public procurement have also been included in some bilateral trade treaties of the United States. Following the protests from steel producing countries against

[6] As of 1 March 2009, the WTO had 153 member states.

[7] Note, however, that one of the exceptions from the 'Buy American' rule is that it does not apply if the use of domestic material would increase the cost of a given project by 25 per cent.

the initial text of the "Buy American" provision, a caveat was inserted, according to which the policy must be implemented in a way that does not violate the United States' international trade obligations. This effectively means that the domestic-sourcing requirements should not apply to the signatories of the WTO Agreement on Public Procurement (like the EU, Japan or Korea) and those countries with bilateral trade agreements with the US (like Canada or Mexico which are parties to the North American Free Trade Agreement). However, a number of other major iron and steel exporters – such as Brazil or China which are neither parties to the plurilateral WTO agreement nor have bilateral agreement with the US – will be affected.

I.1. Balance-of-Payment Exception

The GATT has a number of *exceptions* that may justify otherwise GATT-inconsistent measures. One of them is the "balance-of-payments" exception that permits imposition of trade restrictions to safeguard a country's external financial position.[8] When the balance of payments becomes negative, which can be caused by a decline of exports or increase in imports (or both), the country's foreign exchange reserves can become low.[9] One way to deal with this problem is to restrict imports.

Even though resorting to this exception may well be legitimate, it should be remembered that the provisions in question were included in the GATT at the time when the exchange rates were fixed. Under that system, a country with a payment deficit could not devalue easily. However, in the modern world of flexible exchange rates, the exchange rate is considered to be a more appropriate instrument to deal with balance of payments disequilibria and the respective GATT provisions are said to have become largely redundant.[10] From this point of view, some of the more seriously affected European countries which are using the euro (like Ireland and Greece) or whose currencies are pegged to euro (like the three Baltic states and Bulgaria) may face particular challenges as they do not benefit from currency depreciation in the way other EU countries do (Poland, Czech Republic, etc). However, given that the EU is a customs union, any external trade measure can only be taken by the Union as a whole and not by its individual member states.

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[8] See Article XII (for developed countries) and Article XIIIb (for developing countries) of the GATT.

[9] The 'balance of payments' (or BOP) measures the payments that flow between any individual country and all other countries. It is used to summarise all international economic transactions for that country during a specific time period, usually a year. The BOP is determined by the country's exports and imports of goods, services, and financial capital, as well as financial transfers. A negative balance of payments means that more money is flowing out of the country than coming in.

[10] P. Mavroidis, *The General Agreement on Tariffs and Trade: A Commentary*, Oxford: OUP 2005, pp. 250-252.

In the past, countries have invoked the balance-of-payments exception as cover for the use of quantitative restrictions. The reliance on this provision by India was the subject of a WTO dispute brought by the United States in 1997, claiming that India's restrictions on over 2,700 products could not be justified by the balance-of-payments rules. The WTO panel, on the basis of information provided by the International Monetary Fund, found that India's monetary reserves at the relevant time had been adequate: the United States won the case.[11]

I.2. National Security Exception

Another potentially relevant exception is found in Article XXI "Security Exceptions" of the GATT, which provides *inter alia* that a contracting party will not be prevented "from taking any action which *it considers necessary* for the protection of its essential security interests … taken in time of war or *other emergency in international relations*".[12] Whether the current economic crisis would qualify as an "emergency in international relations" is an open question. By way of analogy, the measures taken by the Argentinean government to deal with its economic crisis of 1999-2002 have been upheld as necessary for the "maintenance of public order" and the protection of the country's "essential security interests" by some international investment tribunals.[13] It appears, however, that the current economic crisis would need to deepen before it could be considered an "emergency in international relations" in the sense of Article XXI, not least because such emergency is mentioned alongside "war", which sets the benchmark of a supposed disturbance at a rather high level.[14]

The important feature of Article XXI is its apparently *self-judging* character: the text suggests that it is for the country concerned, and *not* for the WTO dispute settlement body, to decide what measures are "necessary" (although the determination of whether the threshold of disturbance has been reached would remain subject to judicial control). This is in stark contrast with Article XX(b) on measures "necessary to protect human, animal or plant life or health", whose formulation does not carry a suggestion of the provision's self-judging nature. Indeed, when applying Article XX(b), the WTO panels and the Appellate Body have placed a burden on the invoking country to

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[11] See *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WTO Panel Report, WT/DS90/R, 6 April 1999; Upheld by the WTO Appellate Body Report, WT/DS90/AB/R, 23 August 1999.

[12] Article XXI:(b)(iii) (emphasis added).

[13] On the Argentinean crisis and its consideration by investment tribunals see section II below.

[14] There has been no WTO case law on Article XXI that would help to understand the scope of the provision. The only relevant pre-WTO panel report, *US – Nicaraguan Trade*, concerned a two-way embargo introduced by the United States in its trade with Nicaragua in the mid-1980s. However, the panel's terms of reference explicitly prevented the panel from judging "the validity of or motivation for the invocation of Article XXI:(b)(iii)".

prove that the measure has indeed been necessary to reach the alleged objective.

I.3. Enforcement

In contemplating a potential breach of an international obligation, a rational government considers the consequences. WTO obligations are enforced through the dispute settlement mechanism, which in many respects has come to be considered as exemplary. However, the perennial problem of international law – lack of effective enforcement tools – is present there too.[15] Despite the generally positive record, compliance with WTO decisions to a large extent remains at the behest of WTO members themselves and subject only to political pressures.[16] The WTO Dispute Settlement Body has a power to authorize imposition of retaliatory measures against the violating member, for example a reciprocal increase in tariffs, but these often hurt the retaliating country, especially those with more dependant economies. Moreover, such retaliatory measures would only increase the overall level of protectionism and would be ultimately counterproductive.

There is also a lack of incentives to avoid a breach in the first place. The main WTO remedy is forward-looking – an obligation to withdraw the measure concerned. There is no monetary punishment for adopting the measure or a duty to compensate the damage caused. In other words, there is no sanction for the past wrongdoing; the obligation is to cease the violation for the future. Such system would only seem to be effective against measures of long duration and does not prevent one-off breaches.

II. International Investment Law

International investment law, comprised of a web of more than 2,600 investment treaties, is not coherent and uniform in the way WTO law is. Each state owes obligations only to those countries with which it has concluded bilateral investment treaties (BITs) or broader economic agreements that contain investment chapters. Investment treaties are concerned not so much with protectionism (even though some of them do contain market access commitments); rather they establish the standards of treatment of foreign investments operating in host States. Compared to the WTO law, investment treaties offer a greater incentive for compliance – if a

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[15] An eminent Indian lawyer Fali Nariman once rather frankly noted that "a decision of an international court rendered in a dispute between two sovereign States … has no greater validity or force than a polite request… Any order of an extra-national authority, howsoever pre-eminent, is simply unenforceable if the Government of a nation State chooses not to comply with it." (*Enforcing Arbitration Awards under the New York Convention: Experience and Prospects*, New York: United Nations 1999, p. 13.)

[16] Countries have resisted implementation of the WTO rulings where those have touched upon sensitive areas. One may recall the banana or beef hormones cases against the European Communities and a series of the so-called 'zeroing' claims against the United States.

violation by a state is established, it will be required to pay compensation for the damage suffered by a foreign investor as a result.

The Argentinean crisis of the early 2000s triggered nearly 40 BIT claims against Argentina, many exceeding US$100 million. The Latin American country became the most frequent respondent in international investment disputes and has already been ordered to pay more than US$1.15 billion in damages (the majority of proceedings are still pending). Should we expect that the current global crisis will trigger numerous claims, in the same way the Argentinean crisis did, but this time against countries all over the world?

Even if arbitrations are indeed initiated, the causes of action will likely be different. Claims against Argentina largely arose due to the Government's dismantling of the regulatory and contractual framework created in the early 1990s to attract foreign investment and, most importantly, abandoning the 1-to-1 peso-dollar parity, guaranteed to foreign investors at the time. In current circumstances, measures taken by governments do not appear to breach any specific *contractual* commitments.

If there is a treaty obligation which can provide grounds for claims, it would be non-discrimination. Most investment treaties include a "National Treatment" provision that guarantees to foreign investors and their investments treatment no less favourable than that afforded to domestic enterprises. In other words, it prohibits discrimination – both *de jure* and *de facto* – on the grounds of nationality of the owner of an investment.[17]

Concerns about non-discrimination have already been raised on some occasions. For example, Ireland enacted legislation providing state guarantees on deposits at its largest banks but did not extend such guarantees to foreign banks operating in the country. The European Commission had to interfere, and the initial measures were subsequently extended to foreign banks "with a significant and broad-based footprint in the domestic economy" but not to all of them. The UK has been reported to refuse assistance to LDV, a UK-based and Russian-owned van manufacturer, allegedly on the grounds that it considered that the Russian owner should provide the required support. The German government has been debating whether it should bail out Opel, a German subsidiary of the General Motors Company (US).

When making a case of discrimination under a National Treatment provision, a claimant will need to establish at least the following elements:

- That its investment was in like circumstances with entities that received governmental support: relevant similarity may be in terms of

[17] Note also that BITs also contain most-favoured nation (MFN) clauses, which prohibit discrimination vis-à-vis other foreign investors. An MFN provision could be relevant when a host government grants assistance to one foreign enterprise but refuses to grant it to a similarly-situated one from another country.

industry, size, public importance, or causes and gravity of its financial difficulties.

- That the discrimination was based on nationality (i.e., as a means of conferring advantage to domestic actors) and not on other factors: some arbitral tribunals have considered that when a government discriminates on rational public policy grounds, there is no violation. For example, in support of its position, the government could point to similar *domestic* entities that have not been granted support.
- That it suffered monetary damage as a result of the discriminatory act.

Of course, existence of an applicable investment treaty is a prerequisite for any proceedings. In the case of Ireland, mentioned above, few claims could be brought because it only has one BIT – with the Czech Republic. Furthermore, the language of a specific provision needs to be examined carefully in every case. For example, some BITs only require that national treatment is granted "to the extent possible" or completely exclude certain sectors such as banking services from the provision's coverage.

A different issue arises when in return for financial aid, a government requires the company to undertake that it will maintain its factories and jobs *in that country* – this condition was attached to the French loans to Renault and Peugeot. If the company still needs to cut the jobs, it would have to do it at its *foreign* factories. Such a condition may seem unfair on foreign countries and their workers, but does not appear to be caught by investment treaties, as the latter do not impose *any* obligations on investors' *home* states.

II.1. Necessity Defence

One issue that is bound to come up in the context of any post-crisis investment claim is the so-called "necessity" defence. In international law, "state of necessity" refers to situations where a state's sole means of safeguarding an essential interest threatened by grave and imminent peril is to act inconsistently with its international obligation to another state.

Argentina has raised the necessity defence in all claims brought against it, arguing that the measures taken by its government had been justified by the economic emergency. The results have been mixed with some tribunals rejecting Argentina's plea and ordering compensation[18] and others accepting it and absolving Argentina from liability during the relevant period.[19] In the

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[18] *CMS Gas Transmission Company v. The Argentine Republic,* ICSID Case No. ARB/01/8, Award of 12 May 2005; *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Award of 22 May 2007; *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award of 28 September 2007; *BG Group Plc v. Argentine Republic*, UNCITRAL, Final Award of 24 December 2007.

[19] *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability of 3 October 2006, Award of 25 July 2007; *Continental Casualty Company v. Argentina*, ICSID Case No. ARB/03/9, Award of 5 September 2008.

most recent case, *Continental Casualty v Argentina*, the Arbitral Tribunal held that the crisis-management economic policies of the Argentinean government were necessary to "maintain public order" and to protect Argentina's "essential security interests".[20]

Recent jurisprudence distinguishes between two types of necessity defence – the first under a specific applicable BIT and the second under customary international law[21] (previously, tribunals tended to conflate them). Under both types, the requirement for a measure to be "necessary" is *not* self-judging and forms part of an arbitral inquiry. However, analysis of the case law suggests that necessity clauses in BITs pose less stringent requirements overall; it is significantly easier for a respondent to satisfy them than the customary international law rules on necessity.[22] Also, the BIT necessity clause automatically absolves a respondent from the obligation to compensate, while under customary law the issue of compensation persists.[23] However, not all BITs contain a necessity provision, and if a case is brought under a BIT absent such a clause, a respondent government will find itself in a more difficult position.

III. State Aid Law

As result of the crisis, more businesses turn to governments for assistance, which gives rise to state aid concerns. In the normal circumstances, state aid[24] has a potential to distort competition in the markets in which the firms compete and reduce efficiency. The current exceptional circumstances – while warranting greater resort to state aid to failing firms – are not supposed to set aside the legal framework completely; the latter continues to be a check on possible abuses.

Since October 2008 banks have been the major recipients of governmental support. It has been pointed out that banks are fundamentally different from other businesses: the failure of one bank may lead to a run on others, as opposed to other sectors where the removal of one player would normally be in competitors' interests.[25] The collapse of confidence in turn causes liquidity to disappear and severely affects other banks and businesses, including

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[20] *Continental Casualty Company v. Argentina*, paras. 196-97.

[21] Customary international law on this issue is codified in Article 25 of the ILC Articles on the Responsibility of States for Internationally Wrongful Acts.

[22] See, in particular, the discussion in *Continental Casualty Company v. Argentina*, paras 162-169.

[23] For details, see S. Ripinsky with K. Williams, *Damages in International Investment Law*, London: British Institute of International and Comparative Law 2008, pp. 338-353.

[24] State aid can take many forms, such as cash grants, low-interest loans, tax advantages, sale of inputs at below market prices, purchase of outputs at above market prices or government guarantees of the firms' credit.

[25] J. Fingleton, 'Competition Policy in Troubled Times', 20 January 2009, p. 6, available at http://www.oft.gov.uk/shared_oft/speeches/2009/spe0109.pdf (accessed 20 February 2009).

fundamentally sound ones. A bank's insolvency would also expose governments to the risk of large payouts to depositors. The objective of governmental aid is to help the banks to resume their critical function for the economy as a whole.[26]

International obligations on state aids are found in WTO law. State aid disciplines also exist on the EU level. It is useful to see how the anti-crisis assistance provided by governments worldwide can be squared with existing legal rules.

III.1. WTO Rules

The WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement") is based on a premise that subsidies (a WTO term for state aid) have a damaging effect on international competition and distort international trade flows. Accordingly, the SCM Agreement regulates governments' resort to subsidies. (Agricultural subsidies are treated separately in the WTO Agreement on Agriculture.) Importantly, the SCM Agreement applies only to trade in goods; consequently, it does *not* cover subsidies to institutions that provide financial services such as banks or insurance companies.

A WTO member hurt by another member's subsidy has right to bring legal proceedings against the latter and request the subsidy to be removed. Additionally, the SCM Agreement allows the adversely affected WTO members to unilaterally introduce *countervailing duties* (above the normal import duties) at a level that will cancel out the unfair advantage conferred by the subsidy to the exported product. This system is relatively effective in removing the effects of the subsidies as far as *imports* of subsidized goods are concerned. However, countervailing duties cannot address the disadvantages suffered by products from third countries that compete with subsidized products *in the market of the subsidizing country*. Say, for example if the Swedish automobile industry receives a major subsidy, countervailing duties imposed by Japan can help to prevent Swedish cars from receiving an unfair advantage in the Japanese market, but will not ensure equal competitive opportunities for Japanese cars on the *Swedish* market. The only way to address this situation is to have the violating WTO member withdraw the subsidy. Under the WTO law, one cannot demand that the subsidies granted be *paid back*. For this reason, the WTO framework may be of limited use as far as the one-off rescue packages (as opposed to the lasting support measures) are concerned.

III.2. European Level

The European Union's state aid regime is different from the WTO regulation of subsidies in several respects. Under the EU system, member states must notify the European Commission *before* the aid is granted. If a state aid has

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[26] *Ibid.*

not been notified to the Commission or has been granted before receiving the authorization or against the authorization of the Commission, the Commission may require the offending member state to *recover* the aid. If the member state does not comply, proceedings in the European Court of Justice may be initiated and significant fines imposed on the state.

The EC Treaty's general prohibition of state aid "which distorts or threatens to distort competition" (Article 87.1) contains a number of exceptions, one of which concerns "aid to remedy a serious disturbance in the economy of a Member State" (Article 87.3(b)). The Commission has decided that the measures being adopted in response to the current crisis fall under this derogation and has authorized state aid on numerous occasions since October 2008.[27] The Commission accepted that state aid may be necessary to unblock bank lending to companies and that "liquidity squeeze" was affecting "not only weak companies without solvency buffers, but also healthy companies which find themselves facing a sudden shortage or even unavailability of credit".[28] On the other hand, the Commission has underscored a need to ensure a level playing field for European companies and to avoid member states engaging in "subsidy races" which would be detrimental to the Community as a whole.[29] When dealing with state aid to financial institutions, the Commission decided that it will consider a particular measure compatible with the common market, if it is:[30]

- *Non-discriminatory*. For example, when guaranteeing banks' liabilities, all institutions incorporated in a member state concerned, including subsidiaries of other Member States' banks, must be covered by the scheme.[31]
- *Well-targeted*. States should differentiate between illiquid but otherwise fundamentally sound financial institutions, on the one hand, and those suffering from endogenous problems linked to their particular business model or investment strategy, on the other.[32]
- *Proportionate*. State support must be clearly defined and limited in scope to what is strictly necessary to address the crisis in financial markets while excluding unjustified benefits for shareholders of financial institutions at the taxpayer's expense.[33]

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[27] The list of state aids authorized in the context of the current crisis can be found at http://ec.europa.eu/competition/sectors/financial_services/financial_crisis_news_en.html (accessed on 3 March 2009).

[28] Communication from the Commission, 'Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis', 2009/C 16/01, OJ C 16, 22.1.2009, p. 2.

[29] *Ibid.*

[30] *Idem*, pp. 4-8.

[31] Communication from the Commission, 'The application of State aid rules taken in relation to financial institutions in the context of the current global financial crisis', 2008/C 270/02, OJ C 270, 25.10.2008, para. 18.

[32] *Idem*, para. 14.

[33] *Idem*, paras. 25, 39.

- *Temporary*. Any general scheme, like bank guarantees, must be reviewed by the member state concerned every six months to see whether the continued application of the scheme is justified.[34]
- *Designed in a way to minimise negative spill-over effects on competitors*. Support schemes should include behavioural constraints ensuring that beneficiary financial institutions do not engage in aggressive expansion to the detriment of competitors not granted such support.[35]

Since the beginning of the crisis, state aid measures such as guarantees or recapitalisation schemes have been cleared by the Commission very quickly, when necessary within 24 hours.

On the whole, compared to its WTO counterpart, the EU system is broader in scope (applies to financial services) and more easily adjustable to an economic meltdown. The strict and detailed WTO anti-subsidy regime is compensated by the absence of effective remedies, especially in cases of one-off aid; this potentially makes it easier to disregard the WTO disciplines. The EU regime, with its pre-authorization requirement and the power to recover unlawful aid, is tougher but at the same time more flexible (see the "serious economic disturbances" exception), which has permitted the European Commission to authorize state aid with remarkable efficiency.

Concluding remarks

Today's legal environment should make it significantly more difficult for governments to resort to unchecked protectionism than in the 1930s. WTO disciplines prevent states from erecting barriers to international trade above the agreed levels. Investment treaties and the rules on state aids/subsidies generally prohibit discriminatory actions that would support domestic producers at the expense of foreign-owned enterprises.

At the same time, there is scope for what some would call "smart" protectionism, i.e. taking advantage of the gaps in international regulation – for example, changing immigration legislation to cut the jobs available to foreigners, favouring domestic products in public procurement, increasing import tariffs from "as applied" to "as committed" levels or manipulating trade flows with less obvious instruments like sanitary or technical standards. Not all protectionist actions are by definition inconsistent with international law, and there remains considerable scope for a policymaker's creativity.

Of course, there is also a perennial question of whether international law matters at all. Its particular features – such as absence of effective enforcement mechanisms and rarity of retroactive remedies – weaken its effectiveness. Factors inducing compliance with international law –

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[34] *Idem*, paras. 24, 41.
[35] *Idem*, paras. 27, 38.

reputation, reciprocity and retaliation[36] – may function relatively well under normal circumstances. However, their effectiveness would seem to diminish in times of turmoil when each state's self-preservation interest is likely to prevail, unless there is an honest commitment to tackle the crisis through cooperation. In the past, countries have acted in breach of international law when they considered their national interests to heavily outweigh the payoffs from compliance: the invasion of Iraq and the construction of the Israeli wall are recent examples.

It would seem, however, that to trigger mass non-compliance, the crisis would need to assume proportions that would be "life-threatening" for particular national economies. In any event, resisting protectionist temptations should be in the long-term interests of states themselves, for economic and legal reasons alike. The lessons of the 1930s should be kept in mind: in difficult times, solidarity and cooperation offer the best way forward.

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[36] See A. Guzman, *How International Law Works: A Rational Choice Theory*, Oxford: OUP 2008.