



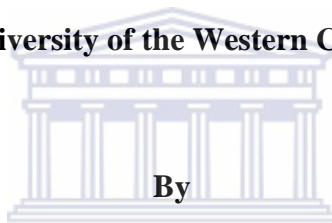
**UNIVERSITY** *of the*  
**WESTERN CAPE**

**State-aid, subsidies and government bail-outs and their impact on international trade:  
A critical look at subsidies for financial services with particular focus on trade finance.**

**Research Paper submitted in partial fulfilment of the requirements for the MPhil degree**

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## **Declaration**

‘I declare that *State-Aid, Subsidies and Government Bail-Outs and their impact on International Trade: A critical look at subsidies for Financial Services with particular focus on Trade Finance* is my own work, that it has not been submitted before for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged as complete references.’

Nigel Simba Matanga

November 2013

Signed .....



## **Acknowledgements**

I would like to thank firstly God for giving me an opportunity to study further in the midst of so many challenges, my family for their support, patience and motivation, my girlfriend for all the understanding, patience and encouraging words and last but not least my supervisor for the guidance and direction. Thank you all for making this possible.



## List of abbreviations

ADB	Asian Development Bank
AfDB	African Development Bank
AOA	Agreement on Agriculture
ECA	Export Credit Agency
ECIC	Export Credit Insurance Corporation
ESCAP	Economic and Social Commission for Asia and the Pacific
EESA	Emergency Economic Stabilization Act
EXCON	Exchange Control
EXIM Banks	Export and Import Banks
GATS	General Agreement on Trade in Services
ICC	International Chamber of Commerce
IFA	International Forfaiting Association
IMF	International Monetary Fund
SCM	Agreement on Subsidies and Countervailing Measures
TARP	Troubled Asset Relief Programme
UCC	Uniform Commercial Code
UCP	Uniform Customs Practices
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNIDROIT	International Institute for the Unification of Private Law
URC	Uniform Rules for Collection
WTO	World Trade Organisation

## **Key words**

Aid-for-trade

Subsidies

Government support

Trade finance

Bail-outs

World Trade Organisation (WTO)



Global financial crisis

General Agreement on Trade in Services (GATS)

Agreement on Subsidies and Countervailing Measures (SCM Agreement)

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# **Chapter One**

## **1.1 Introduction and Background**

The great significance placed on the financial system in any economy stems from the impact that the financial sector has on most, if not all of the other sectors in the economy. The primary and secondary sectors of an economy may focus on raw material production and production of goods (processing of raw materials) respectively, but they rely on the tertiary sector, sometimes combined with the quaternary sector, for services to reach the end user. It is within the tertiary sector that the financial system plays a momentous role.<sup>1</sup>

The financial system according to Herring and Santomero<sup>2</sup> is a catalyst for savings as well as investments. Primary and Secondary sector players are able to put aside and accumulate funds in order to invest for expansion or even diversification into new business areas. The financial system thus affords them an opportunity to accrue reserves while benefiting from interest earned on those savings. Trade transactions are also channelled through the financial system. This means that for trade to take place, a reliable and efficient financial system must be in place. This could be in the form of trade service facilities such as credit allocation,<sup>3</sup> foreign currency procurement, and in the case of international trade, international payment system services such as letters of credit.<sup>4</sup>

The financial sector can also be viewed as an intermediate service provider in the economy between those looking to inject wealth for further wealth creation and those looking for finance to fund their projects. Both investors and borrowers make use of many of the numerous financial

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<sup>1</sup> Kenessey Z 'The Primary, Secondary, Tertiary and Quaternary sectors of the economy' (1987) *Journal of the International Association for Research in Income and Wealth* 363

<sup>2</sup> Herring, Santomero 'The Role of The Financial Sector in Economic Performance' (1996) The Warton School Working Paper 95-08.

<sup>3</sup> Credit allocation is the systematic distribution of funds to clients requiring short to medium term financing for procurement of stock for resale or raw materials for production.

<sup>4</sup> Letter of credit is a document that acts as a guarantee of payment to a beneficiary and is issued by a bank to facilitate the process for international trade transactions.

See [http://www.unescap.org/tid/publication/tipub2374\\_chap2.pdf](http://www.unescap.org/tid/publication/tipub2374_chap2.pdf). (Accessed 24 August 2012).



instruments in order to meet their needs and expectations. It is through this interaction of the various parties that the financial system exists and that the financial needs of the economy are addressed.<sup>5</sup>

In light of the vast contribution that the financial system makes towards the sustenance and development of the economy, one can conclude that it (the Financial System) is integral to the performance of the other sectors in the economy and its demise has a negative impact on the rest of the economy. Therefore, the financial sector needs to be constantly under close monitoring and supervision in order to safeguard the economy from collapse or meltdown. Regulation and supervision of the financial system are thus vital to the success of a country. Growth and development can only truly be achieved in the realm of a well structured and regulated financial system.<sup>6</sup>

Given that financial services in an economy are crucial for the facilitation of business transactions, it would be prudent to recognise the great importance of financial services to trade especially across borders and regions. Various global organisations have been established in an attempt to ensure that financial systems and global trade flows take place effectively. These include the World Bank and International Monetary Fund as well as the World Trade Organisation. The World Trade Organisation (WTO), which is the main international body that aids the liberalisation of trade as well as sets the tone for global trading principles, plays a part in outlining principles that ensure an efficient and fair trading system.<sup>7</sup> The International Monetary Fund (IMF) and World Bank are world governing bodies that deal with financial and economic matters across the globe. The roles and areas of focus of the WTO, IMF and World Bank may be different but to a large extent can be considered complementary to each other. This can be seen in the way that financial policy affects trade flows and how trade may have a bearing in the way that financial systems are governed and monitored. Financial services, in a trade context fall

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<sup>5</sup> Chami R, Fullenkamp C & Sharma S 'A Framework for Financial Market Development' IMF Working Paper 09/156 4-5

<sup>6</sup> Claus I, Jacobsen V & Jera B 'Financial systems and economic growth: An evaluation framework for policy' (2004) 17 *New Zealand Treasury* 4 2-4.

<sup>7</sup> See ,e.g. World Trade Organisation at [https://www.wto.org/english/thewto\\_e/whatis\\_e/whatis\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm) (accessed 24 August 2012).

under the auspices of the General Agreement on Trade in Services (GATS). An inter dependency exists between trade and the financial sector particularly with regards to financial services. The inter-dependency stems from the fact that international trade, whether in goods or services, must be channelled through a well functioning financial system; while financial system stakeholders must adhere to the principles set out in the WTO rules in order to trade with foreign parties. The objectives of the WTO and IMF can be viewed as complementary to each other when analysed from economic and social development levels as both look to achieve for example economic growth; an objective for the IMF which can be facilitated by growing markets created by international trade, that can be brought about by a reduction in trade barriers; an objective of the WTO.<sup>8</sup> Truman points out that the relationship between trade and the financial markets is more far reaching than was envisaged a few decades ago.<sup>9</sup> The global market has grown significantly over the years and the roles of trade and finance have grown closer and are inter-linked. The WTO has over the years focused on lowering barriers to trade, improving capital flows across national borders and the development of exporters and their industries' welfare. The objectives of the IMF have focused on the domestic welfare firstly of individual nations as it emphasizes economic growth through lowering inflation and interest rates, increasing foreign currency reserves and improving the balance of payments of nations.<sup>10</sup>

The financial meltdown of 2008, which originated in the US financial system, affected the entire global system in one way or another.<sup>11</sup> This subsequently had negative impacts on trade and especially trade finance. The drying up of credit meant that access to trade finance was limited and thus affecting the actual trade of goods and services as there was no working capital for importers and exporters. Working Capital can be defined as short term assets used for the

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<sup>8</sup> See IMF 'The IMF and World Trade Organisation' at <http://www.imf.org/external/np/exr/facts/imfwto.htm> (Accessed 23 May 2013).

<sup>9</sup> Truman EM 'Linkages between International Trade and Financial Markets: Mapping the Issues' (2010) *Halle Institute for Economic Research* 1-6.

<sup>10</sup> Truman EM 'Linkages between International Trade and Financial Markets: Mapping the Issues' (2010) *Halle Institute for Economic Research* 1-6.

<sup>11</sup> Delimatsis P 'Of Bailouts and Rescue Measures: Subsidies in Financial Services' (2012) 24 *National Centre of Competence in Research Trade Regulation* 1-5.

operating activities of a business.<sup>12</sup> These operating activities could include the procurement of merchandise for re-sale or inputs for manufacturing as well as the costs of carriage. This caused a slowdown in growth for many economies and governments were forced to intervene in order to resuscitate their financial systems such as the bailing out of big corporate financial services providers. The arguments for the government interventions have merit from a developmental and macro-economic viewpoint. However, when seen from a trade related perspective, the subsidies given to these institutions in the form of bail outs may contravene some trade rules.

## **1.2 Aims of the Research**

### **Research Question**

Does the bailing out of banks in distress during a financial crisis constitute a subsidy and a subsequent contravention of trade rules?



### **Research Objectives**

- 1 To outline the extent to which Trade Finance plays a role in global trade
- 2 To explore the WTO rules on Subsidies and aid for trade with special emphasis on the SCM agreement as well as other WTO agreements (GATT and GATS)
- 3 To show the trade enhancing and trade distorting consequences of government intervention through bail outs, aid for trade and subsidies
- 4 To assess and evaluate the suitability of the current trade law framework for trade in financial services in view of the above consequences.

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<sup>12</sup> Marx J *Finance for Non-Financial Managers* 2 ed (2009) 111.

### 1.3 Rationale for the research

The financial crisis that was triggered in the developed countries affected the entire global financial system. Trade and Industry across the world was impacted negatively and this gave rise to the need for preventing another financial meltdown.<sup>13</sup> As part of the evolving nature of the business environment, lessons need to be drawn from past disasters to prevent future collapses of the systems in place. Governments in the developed world injected financial resources into the failing industries that they deemed to be crucial in order to restore and maintain financial stability. These measures may be viewed as a violation of trade rules regarding the use of subsidies.<sup>14</sup> Others may view government participation in the market as not necessarily being trade distorting but rather trade enhancing and therefore in accordance with international trade rules.<sup>15</sup>

This paper will attempt to outline the significance of government involvement and will look at the advantages and disadvantages for the nation instituting that government support. It will also look at the advantages and disadvantages from the perspective of other nations with similar industries and interests in the financial sector, competing for global market share. This would be followed by determining whether the aid is permissible under trade law rules.

The impact of the drying up of credit and poor liquidity on trade finance and subsequently on global trade was amplified by the financial crisis of 2008. This was the worst banking crisis since the 1930's and international policy makers were quickly enlightened on the various flaws of the regulation of global financial services and had to act in order to combat the effects of credit drying up and unavailability of trade finance.<sup>16</sup> Access to trade finance and its various

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<sup>13</sup> IMF 'Trade Finance in Financial Crises: Assessment of Key Issues' (2003) at <http://www.imf.org/external/np/pdr/cr/2003/eng/120903.htm> (Accessed 23 May 2013).

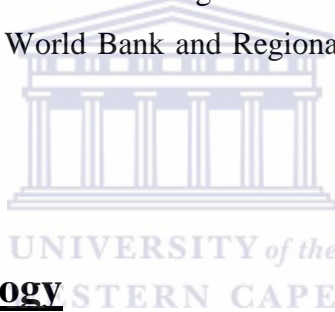
<sup>14</sup> See General Agreement on Tariffs and Trade (GATT) 1994 Article XVI and Article 1 of Agreement on Subsidies and Countervailing Measures

<sup>15</sup> Stiglitz J, Jaramillo-Vallejo J & Chal Park Y 'The role of the state in financial markets' (1993) *Annual Conference on Development Economics Supplement* 61

<sup>16</sup> Lastra RM & Wood G 'The Crisis of 2007-09: Nature, Causes and Reactions' (2010) 13 (3) *JIEL* 534-535.

instruments is paramount to the facilitation of international and local trade. Export and Import related funding is particularly crucial in long term macro-economic matters such as foreign currency procurement as well as balance of payments especially for the less developed nations.<sup>17</sup> This means that a developing country's growth is to a great extent dependent on trade and remittances from foreign countries for goods and services exported. For this to take place, the financial sector in that country needs to be robust and be a platform for trade transactions to effectively and efficiently occur.

This paper will attempt to address the effect of subsidies on the availability of trade finance for both developed and developing countries. This will be in pursuit of establishing whether access to bail out funds has a positive or negative effect on the development of global trade through the economic principles of absolute and comparative advantage as well as trade law with regard to WTO rules. An examination of the role of global financial institutions in ensuring the availability of trade finance (IMF, World Bank and Regional Development Banks) will also be carried out.



## **1.4 Research Methodology**

A literature based study will be carried out with focus mainly on the available legal material such as World Trade Organisation Agreements i.e. the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS), the Agreement on Subsidies and Countervailing Measures (SCM Agreement) as well as reports on research done by the WTO on the financial crisis and the measures that were and/or are being taken to remedy the drying up of credit that is affecting or affected trade finance and ultimately global trade. The European Union law on state aid will be used as a yardstick for comparison with the WTO rules on subsidies. This, along with academic papers, scholarly articles and internet sites for up to date news on the subject as well as any new developments, will be used to answer the question of whether government bail outs should be regarded as trade distorting subsidies.

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<sup>17</sup> ODI 'Balance of Payments Stabilisation Policy in Developing Countries' at <http://www.odi.org.uk/publications/5514-balance-payments-stabilisation-policy-lDCs> (Accessed 23 May 2013).

## 1.5 Scope of the research

The scope of the paper will mainly focus on trade finance and the current rules governing support for financial institutions that provide trade assistance and finance international trade. The global financial meltdown will only be dwelt on briefly so as to give the background of the drying up of credit, increase in liquidity risk<sup>18</sup> and the crisis effects on export credit agencies. These are all aspects that subsequently affected and still affect trade finance and trade across nations. The unavailability of trade finance thus can be seen as a trade barrier and creates challenges for both importers and exporters.<sup>19</sup> Therefore the focus of the research will be on trade finance and the government subsidies used to support trade finance deficiencies.



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<sup>18</sup> Liquidity risk is the chance that an asset cannot easily be turned into cash at a reasonable price- See Gitman LJ *Principles of Managerial Finance* 13 ed (2012) 71.

<sup>19</sup> IMF 'Trade Finance in Financial Crises: Assessment of Key Issues' (2003) at <http://www.imf.org/external/np/pdr/cr/2003/eng/120903.htm> (Accessed 23 May 2013).

## **1.6 Overview of chapters**

### 1.6.1 Chapter 1

Chapter one will create the milieu for the research problem by pointing out the linkages of the financial crisis in brief with the immediate effects on the global financial system and particularly on trade finance. This setting will be done to show the ways in which the financial service providers fit into trade and how the global financial crisis of 2007-8 affected trade flows. This chapter will be the introduction and background for the study.

### 1.6.2 Chapter 2

Chapter Two will begin with defining trade finance and the various aspects of Trade finance. The key issues that are currently being deliberated on will be outlined as well as a further more in-depth study into the role that trade finance plays in global trade. In this chapter most of the instruments and players in trade finance will be identified. The chapter will also look into the financial crisis and its impact on trade finance.

### 1.6.3 Chapter 3

The hub of this chapter will be the issue of subsidies. The chapter will include the definition of a subsidy and relate it to the state-aid and bail-outs that governments employ to support ailing industries. Comparisons of subsidies in trade of goods and in financial services will be conducted to extract the key differences and similarities that could be used to address the issue of trade finance shortage and the intervention thereof from governments.

### 1.6.3 Chapter 4

This chapter will look into the various forms of government intervention that are employed to address the effects of the financial crisis. This chapter will reconcile the preceding chapters by discussing the relevant trade law aspects that will be used to answer the research question. It will discuss the relevant aspects of the WTO agreements that address the employment of government intervention in the financial sector and also look at other rules that deal with the use of state aid beyond the legal framework of the WTO looking into the welfare of a broader spectrum of trade

participants and stakeholders. The roles of institutions other than the WTO will be outlined in order to build a basis on which to address the research question as well as legal conjectures of government support through subsidies will also be highlighted in this chapter. The core rule based system will be the EU law on state aid as well as the EU Treaty. The aim of this chapter will be to extract the relevant issues addressed by the respective rule making bodies with regards to government support for firms and industries in distress particularly in financial services.

#### 1.6.5 Chapter 5

This chapter will be the overall conclusion of the research drawn from the preceding chapters' arguments and findings. The chapter will also re-emphasize the current deficiencies of trade law aspects regarding trade finance and government support through subsidies. It will also outline recommendations to the global trade and economic institutions for future interactions between governments and their support and assistance for the ailing financial aspects of trade in their countries.





## **Chapter Two-Trade Finance and its role in International Trade**

### **2.1 Introduction**

The phrase ‘More money, more problems’ is a phrase that has been used in urban contemporary language.<sup>20</sup> The irony in that saying is that many do what they can to get money in order to solve their needs and even wants. However, as they acquire more wealth, their experiences in life change and this brings about more financial constraints in order to live up to that newly found lifestyle. Those new-fangled constraints are what lead to the phrase having some merit.<sup>21</sup> Maslow’s hierarchy of needs points out that people must meet their physiological and security needs first as these are fundamental to their survival.<sup>22</sup> When persons cannot meet their fundamental needs because of a lack of funding, then their problems should far out-weigh those of esteem and actualization as faced by those with wealth who have *seemingly* bigger problems because of the excess they have.

Relating the term person, as mentioned above, to organisations or businesses, a lack of funding could mean failure to be a going-concern<sup>23</sup> or even begin to operate. A business needs financing in order to function, therefore a lack thereof, contrary to the phrase ‘more money, more problems,’ means that it cannot trade, operate or meet its financial obligations. One can then conclude that the phrase is definitely not valid when discussing the financial need of a business to exist.

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<sup>20</sup> <sup>20</sup> See ,e.g. The Definitive Guide to Self-Improvement at <http://briankim.net/blog/2008/03/the-meaning-behind-more-money-more-problems/> (visited 25 October 2012).

<sup>21</sup> See ,e.g. The Definitive Guide to Self Improvement at <http://briankim.net/blog/2008/03/the-meaning-behind-more-money-more-problems/> (visited 25 October 2012).

<sup>22</sup> See ,e.g. Maslow’s Hierarchy of Needs at <http://www.comprofessor.com/2010/04/maslows-hierarchy-of-needs.html> (visited 31 October 2012).

<sup>23</sup> Going concern is ‘A term for a company that has the resources needed in order to continue to operate indefinitely. If a company is not a going concern, it means the company has gone bankrupt.’ Read more: <http://www.investopedia.com/terms/g/goingconcern.asp#ixzz2AsnfTLOV> (visited 31 October 2012).

The financing of a business can be done in two different ways. The first includes forms of financing such as long term debt, preference shares and common equity which are used to provide capital to establish or grow a business through investors, who in turn receive a return in the form of interest payments for debt holders, preference dividends for preference share holders and dividends for common equity holders.<sup>24</sup> When a business requires funding for operational expenses, that form of capital is not directly investor induced but rather normally entails credit with banks through overdrafts or short term loans. This type has to do with the facilitation of a specific order or transaction that the business may want to fulfil. This is termed working capital or Trade Finance. This chapter is going to discuss working capital and trade finance with a greater focus on Trade Finance. It will discuss the various types of trade financing and bring into context the extent to which it plays a role in global trade. The legal framework governing the use of the major types of trade financing will also be discussed.

## **2.2 Overview of International Trade**

The Global market is the ultimate playing field for businesses across the world. Businesses that aim for growth at a faster pace will inevitably venture outside their national borders in order to achieve greater sales. They achieve this by creating opportunities for themselves to lure additional consumers for their products and services. Greater sales in turn translate to higher profits and returns on investment. Trade has thus been considered, for instance, as the “motor of world economic growth.”<sup>25</sup> However, as firms across the world converge on creating opportunities for international expansion, competition for consumers between firms buying and selling similar products comes into play. Competition can be defined as a scenario in which two or more parties have conflict as a result of their goals being partially or totally mutually exclusive.<sup>26</sup> This means that the choice of one excludes the other from being chosen. For example in the context of competing firms, if two dealerships, both selling the same types of vehicles are competing for a customer with a budget for only one vehicle, when the customer

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<sup>24</sup> Gitman LJ & Zutter CJ *Principles of Managerial Finance* 13 ed (2012) 360.

<sup>25</sup> Jepma CJ & Rhoen AP (eds) *International Trade: A Business Perspective* (1996) 1.

<sup>26</sup> Jepma CJ & Rhoen AP (eds) *International Trade: A Business Perspective* (1996) 7.

picks a vehicle from firm A, it immediately eliminates any opportunity for firm B getting to sell a similar car to this specific customer. In this scenario it could be said that the firms' goals are totally mutually exclusive. Partially exclusive could refer to a situation in which firm A gets the sale but firm B gets to sell accessories to the same customer which firm A does not stock. This would show that they are still competing for the same clients with regards to the same types of vehicles, however firm A and firm B may not necessarily be competing for customers looking at buying accessories. Competition may seem a hindrance to successful business but it is actually a catalyst for improvement of business processes through improving efficiency in innovative ways of making use of limited resources. Firms also strive to be more effective with their current resources thus achieving better outcomes with the same inputs. Overall they aim to be more attractive to consumers. The success of a business may be attributed to its ability to have a competitive advantage that is sustainable. This can be brought about by product pricing and product differentiation in order to attract consumers away from rivals.<sup>27</sup> International customers thus offer a much needed extended market for competing firms in a saturated market.

The growth or expansion possibilities associated with extending a firm's customer base beyond national borders bring about intricacies linked with international trade. These include, but are not limited to, market entry issues or trade barriers such as tariffs, quotas, duties, exchange rate controls, dumping policies and subsidies.<sup>28</sup> It is therefore in the interest of the global community to lower these trade barriers. This will stimulate economic growth that benefits producers and service providers with a competitive edge over rivals as well as end-consumers that in turn benefit from lower priced but same and or even better quality goods.<sup>29</sup>

The cross border nature of international trading also brings with it some business and financial risk. For example, a buyer in South Africa, using Rands (ZAR) may find it cumbersome to successfully import a product from Europe that uses Euros. Many factors can play a part in the

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<sup>27</sup> Porter ME 'The Competitive Advantage of Nations' 1990 *Harvard Business Review* , 73-91.

<sup>28</sup> See ,eg International Trade Agreements and Barriers at [http://www.dotd.la.gov/programs\\_grants/latin/Documents/10%20Sec%20B5%20International%20Trade%20Agreements%20and%20Barriers.pdf](http://www.dotd.la.gov/programs_grants/latin/Documents/10%20Sec%20B5%20International%20Trade%20Agreements%20and%20Barriers.pdf) (accessed 1 November 2012)

<sup>29</sup> See WTO 'The 10 Benefits: Growth and Jobs' at [http://www.wto.org/english/thewto\\_e/whatis\\_e/10ben\\_e/10b07\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/10ben_e/10b07_e.htm) (accessed 23 May 2013).

decision on whether to import or buy locally. Some of those would include the availability of the same or similar product with the same features, similar price and quality in South Africa, the cost of importing and any other regulatory measures in South Africa that may have a bearing on the decision. Access to foreign currency and capital, also known as trade finance, used to fund the purchase plays a significant role in the decision and this study aims to look into this particular aspect of conducting international business.

### **2.3 Trade Finance and Working Capital**

Working capital and trade finance are both forms of short term financing. With regards to working capital, the current assets that a business has in the form of inventories, cash and receivables are used to finance the short term debt obligations such as overdrafts, short term loans and account payables. This form of financing is geared at alleviating short term liquidity problems and allows the business to continue operations. Therefore, while awaiting payments from debtors to settle their accounts, the business may acquire more inventories on credit on the basis that it will be able to settle its own obligations once its debtors have paid.<sup>30</sup>

Trade finance on the other hand works on a similar concept but differs in that it is used for specific transactions especially during cross border trading. While working capital's main objective is to alleviate liquidity problems, trade finance not only addresses funding for businesses in international trade looking to expedite transactions, but aims to mitigate risks associated with international business. The risks in question stem from the exporters' uncertainty of receiving required payment from the importers and importers' uncertainty of receiving the desired quality and quantity from the exporter within the required time.<sup>31</sup>

The risks that trade finance attempts to address can be categorised as follows:<sup>32</sup> Economic risks- buyers' failure or inability to pay for goods, Exchange rate risks- variation in receivables due to

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<sup>30</sup> Gitman LJ & Zutter CJ *Principles of Managerial Finance* 13 ed (2012) 605.

<sup>31</sup> ESCAP *Trade Finance Infrastructure Development Handbook for Economies in Transition* (2005) 4 at [http://www.unescap.org/tid/projects/globalize\\_wgfbk.pdf](http://www.unescap.org/tid/projects/globalize_wgfbk.pdf) (accessed 1 November 2012).

<sup>32</sup> Okolo S 'Risks in International Business' at <http://ezinearticles.com/?Risks-in-International-Business&id=1331702> (Accessed 23 May 2013).

currency fluctuations, Transportation risks- theft, loss or damage of goods in transit and Political risks-foreign, domestic and economic policies eg. war, embargoes and exchange control (EXCON).

Therefore in summary, trade finance aims to provide funding for businesses engaged in importing or exporting, providing services to mitigate the risks mentioned above and providing an efficient system to transact and monitor international payments.

## **2.4 Trade Finance Instruments**

Trade finance makes use of various methods to assist businesses involved in exports and/ or imports. For the purposes of this study, only a brief overview of a few of these will be discussed so as to give a broad context of trade finance in international trade. The following are instruments used by firms to mitigate risk and effect successful collection of payment and of goods:

### **2.4.1 Letter of Credit**

This is “a written undertaking by a bank at the request of an importer/buyer in favour of an exporter/seller whereby the bank agrees to pay against bills of exchange.”<sup>33</sup> The parties in this form of trade finance all play a role ensuring that risks are mitigated and that the seller’s and buyer’s positions are secured. In a nutshell, the importer, who is the applicant for the letter of credit, makes the application to the bank that will issue the letter of credit. This bank becomes the Issuing bank and it notifies a bank in the exporter’s country, named the advising bank that a letter of credit has been issued with the exporter as the beneficiary. This advising bank will then advise the exporter who will in turn ship the goods and pass the documents on to a bank nominated to liaise with the issuing bank called the negotiating bank. At this stage the holder of the documents has all rights and obligations with regards to the shipped goods. The exporter receives payment and once all checks have been carried out and the specifications have been

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<sup>33</sup> See eg, Documentary Credits at

[http://corporateandinvestment.standardbank.co.za/pages/docs/its/doc\\_credits\\_brochure.pdf](http://corporateandinvestment.standardbank.co.za/pages/docs/its/doc_credits_brochure.pdf) (accessed 4 November 2012)

complied with, the documents will be passed on to the importer who then must fulfil the debt obligation created between the importer and the issuing bank.<sup>34</sup>

This form of trade finance has been especially used when the associated risks are high. Reason for this is that the issuing bank takes on a lot of the risk and must then be compensated for that risk, making the letter of credit very expensive for importers. The rules governing letters of credit as outlined in the Uniform Commercial Practice (UCP) 600 emphasize strict compliance. This means that any deviation from the written contracts and documents will lead to non-compliance and non payment on presentation of the documents.<sup>35</sup>

#### **2.4.2 Documentary Collection**

This is similar to letters of credit but differs in that it involves an exporter sending the documents for the shipped goods, via the exporter's bank, to the importer's bank. The documents are only released to the importer when the exporter has received payment for the goods. In this instance, the financial institutions in the process cannot guarantee payment to the exporter thus making it a lower cost option as compared with letters of credit instrument for trade finance.<sup>36</sup>

#### **2.4.3 Forfaiting**

Forfaiting is when a financial institution pays an exporter who is expecting payment from an importer, a discounted amount on the exporter's receivables. In doing this, the forfaiter takes on all the risks and aims to make a margin when the full amount is settled by the importer. Forfaiting awards an opportunity for the forfaiter to make margins on the exporter's receivables while affording an opportunity for the exporter to receive payment sooner which can be used to finance other trade transactions. The exporter will receive a discounted amount but the timing of

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<sup>34</sup> See Trade Finance Methods and Instruments: An Overview at [http://www.unescap.org/tid/publication/tipub2374\\_chap2.pdf](http://www.unescap.org/tid/publication/tipub2374_chap2.pdf) (accessed 23 May 2013).

<sup>35</sup> Gavigan RJ 'Wysko Investment Company v. Great American Bank: A New Attack on the Usefulness of Letters of Credit' (1993) 14 (1) *North-Western Journal of International Law and Business* 184-188.

<sup>36</sup> See Trade Finance Guide at <http://www.trade.gov/publications/pdfs/tfg2008ch4.pdf> (accessed 23 May 2013).

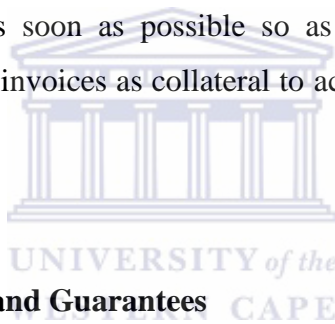
the cash flow will allow for quicker returns and finance to conduct more business instead of losing sales while waiting for payment.<sup>37</sup>

#### **2.4.4 Factoring**

Factoring is very similar to forfaiting in that it also involves payment to exporters for their receivables. However, the major difference is that factoring houses do not take on all the risks as they only pay for any portion of the receivables and not all of them. This lowers their exposure to non-payment by importers but it also lowers their margins.<sup>38</sup>

#### **2.4.5 Invoice discounting**

Invoice discounting unlike forfaiting and factoring is a trade finance tool that uses receivables as collateral for the expediting of loans for an exporter. As mentioned above, it is the interest of a business to receive cash flows as soon as possible so as to finance the next shipments of products. The business will use its invoices as collateral to acquire short term financing so it can generate more sales.<sup>39</sup>



#### **2.4.6 Export Credit Insurance and Guarantees**

These are trade finance instruments used by Export Credit Agencies to cover businesses that are conducting international trade. These services are offered in the form of direct loans or indirect insurance and guarantees to cover commercial and political risks that could arise in international trade business transactions.<sup>40</sup>

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<sup>37</sup> See eg, What is forfaiting at <http://www.forfaiters.org/forfaiting/what-is-forfaiting> (accessed 4 November 2012).

<sup>38</sup> See Trade Finance Methods and Instruments: An Overview at [http://www.unescap.org/tid/publication/tipub2374\\_chap2.pdf](http://www.unescap.org/tid/publication/tipub2374_chap2.pdf) (accessed 23 May 2013).

<sup>39</sup> See Factoring and Invoice Discounting at [http://www.insightassociates.co.uk/uploads/CreativeFinance\\_FactoringInvoiceDiscountingGuide\\_Jan%2007.pdf](http://www.insightassociates.co.uk/uploads/CreativeFinance_FactoringInvoiceDiscountingGuide_Jan%2007.pdf) (accessed 23 May 2013).

<sup>40</sup> See Export Credit Agencies and the WTO at [http://www.ciel.org/Publications/ECA%20WTO\\_Nov03.pdf](http://www.ciel.org/Publications/ECA%20WTO_Nov03.pdf) (Accessed 17 June 2013).



## **2.5 Trade finance rules and institutions**

Given the global reach and importance of trade finance, the monitoring and supervision has to be at an international level as well. There are several rule based systems in place as well as international bodies that play a role in ensuring trade flows. The UCP 600 is the Uniform Customs and Practices for documentary credits and works under the auspices of the International Chamber of Commerce. This set of rules addresses the use of letters of credit. The Uniform Commercial Code (UCC) which is a US code is similar to the UCP 600 but it is a set of rules that are observed only by the 50 states of the United States of America. A major difference is the treatment of strict compliance as the UCC will allow payment on substantial compliance. The United Nations Commission on International Trade Law also has conventions guiding the use of trade finance instruments. Its convention on International Bills of Exchange and International Promissory Notes and the convention on Independent Guarantees and Stand-by Letters of Credit provide a platform for understanding the practices in conducting international trade using the relevant forms of trade finance addressed in the convention.<sup>41</sup>

The URC is the Uniform Rules for Collections and it too is under the auspices of the ICC. Its latest iteration is the URC 522 and these rules are used to guide the use of documentary collections. The International Institute for the Unification of Private Law (UNIDROIT) is an organization that drafts conventions dealing with many aspects of international law. South Africa is a member and of great relevance to this study, also part of the Ottawa conventions on Financial Leasing and Factoring of 1988.<sup>42</sup>

The Global institutions that play a role in trade finance aim to ensure that Trade is not disrupted because of a lack of funds to finance transactions. Many operate under the auspices of the UN, IMF and World Bank. Their role is to facilitate trade and remove the trade barriers that a lack of trade finance creates in international trade. Export Credit Agencies (ECAs) also play a big role in international trade especially with regards to fulfilling developmental objectives. ECAs allow

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<sup>41</sup> See A Guide to UNCITRAL at <http://www.uncitral.org/pdf/english/texts/general/12-57491-Guide-to-UNCITRAL-e.pdf> (accessed 23 May 2013).

<sup>42</sup> See Uniform Rules for Collection at <http://www.tradefinanceguru.net/international-rules/urc> (Accessed 23 May 2013).



exporters to have access to credit at competitive costs given that exporters in more developed countries may have access to subsidized credit, provide loans and guarantees for large transactions with more favourable repayment terms of two to ten years and offer insurance to cover commercial risks like failure to pay by the foreign buyer of goods and services, and political risks like war and changes in regulations that could affect repatriation of remittances.<sup>43</sup> The following are some of the institutions that play a role in trade finance from an ECA perspective: Multilateral Development Banks such as African Development Bank, Asian Development Bank and OPEC Fund for International Development to name a few. Many countries have agencies that would carry out the developmental functions with regards to export promotion. South Africa for instance has the Export Credit Insurance Corporation of South Africa (ECIC) which falls under the auspices of the Department of Trade and Industry.<sup>44</sup> The US has the Export-Import (EXIM) banks which also play the role of support for export credit and insurance in international trade.<sup>45</sup>



## **2.6 Trade finance, International Trade and Financial Crises**

As evidenced by the different instruments used in trade finance, international trade is dependent to a very large extent on exporters being able to get funding to ship their goods as well as importers being able to remit funds for payment for goods and services. The aspect of the banking sector in any country having capital is of paramount importance to international trade and business as a whole. The financial institutions that are the channel for international business transactions need to operate in an environment that is regulated accordingly for monitoring and supervision purposes. Financial stability in the traders' countries is also of great importance as it allows investors in the form of venture capitalists, forfeiters, factoring houses and export credit agencies to participate freely. The banking sector needs to have a constant flow of capital from

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<sup>43</sup> See Role and Importance of Export Credit Agencies at <http://www.gwu.edu/~ibi/minerva/Fall2011/Raquel.pdf> (Accessed 17 June 2013).

<sup>44</sup> See ECIC at <http://www.thedti.gov.za/agencies/ecic.jsp> (Accessed 17 June 2013).

<sup>45</sup> See Understanding the Importance of Export Credit Financing for US Competitiveness at <http://www.itif.org/files/2011-export-credit-financing.pdf> (Accessed 17 June 2013).

participants in the form of lenders and borrowers. The market needs to allow for good competition so that lenders improve their offerings by giving the best service to borrowers and trusting that they will not default.<sup>46</sup>

The drying up of credit is therefore a hindrance to international business. When banks and other financial institutions that would normally fund international trade transactions lose the capacity to offer short term loans for exporters and importers then that becomes a barrier to trade and subsequently will affect economic growth. The financial crisis that affected the US banking sector is one such event that caused a credit crunch. Some of the causes of the financial crisis included imprudent mortgage lending, real estate bubble and questionable practices at the corporate, supervisory and regulatory levels.<sup>47</sup>

The financial crisis drastically affected the US banking sector and this had a negative effect on trade flows as the financial system which traders depend on to channel capital flows, did not have the capacity to facilitate international trade transactions. A collapse in trade slows down growth and increases the likelihood of country deficits and reductions in employment. A drop in employment levels can translate to a nation in distress as government revenue will decrease due to less tax revenue leading to less government support for the various crucial industries that form the backbone of the nation such as education, healthcare, social welfare and infrastructure development.<sup>48</sup> This scenario has to be avoided by governments so they will put measures in place to develop strategies to facilitate trade, develop trade infrastructure, promote trade and manage trade relations.<sup>49</sup> According to the Trade Finance Development Handbook for Economies in Transition, trade facilitation and infrastructure development have a major focus on trade finance. This means that governments have to ensure a working environment for trade finance through their financial systems.

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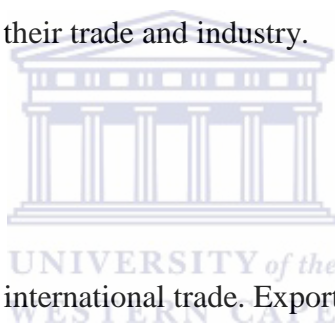
<sup>46</sup> Chami R, Fullenkamp C & Sharma S 'A Framework for Financial Market Development' IMF Working Paper 09/156 4-5.

<sup>47</sup> Lastra R & Wood G 'The Crisis of 2007-09: Nature, Causes and Reactions' (2010) 13(3) *JIEL* 531.

<sup>48</sup> Abel AB & Bernanke BS *Macroeconomics* 5 ed (2005) 448.

<sup>49</sup> Economic and Social Commission for Asia and the Pacific *Trade Finance Infrastructure Development Handbook for Economies in Transition* (2005) 2.

The US credit crunch of 2008, which affected the global financial system including developing countries, meant that banks could no longer lend as they did previously. Default risk had to be addressed more aggressively. A WTO Working group on Trade, Debt and Finance pointed out however that trade finance has a low default risk and has a self liquidating nature as each international trade transaction is dealt with independently and comes to an end automatically when suppliers receive payment; buyers receive their goods and the intermediary banks' short term loans are settled.<sup>50</sup> The Bank of International Settlements (BIS) also shares the view that Trade Finance should in fact be considered as having low credit risk. However given that exporters have access to trade finance and can ship their goods, the credit crunch increases uncertainty on the reliability of the banking sectors involved especially in least developed countries (LDCs). In light of all this, the US government for instance, had to ensure that the financial system was restored to a working status by bailing out major financial institutions whose demise would have affected their trade and industry.



## **2.7 Conclusion**

Trade finance plays a major role in international trade. Exporters and importers alike make use of the various trade finance instruments not only to protect their interests, but also to ensure efficient transaction logistics across borders in international trade. The providers of services in trade finance work under or in conjunction with financial services providers and therefore are strongly dependent on a well functioning financial services system. In the event of a breakdown such as a crisis in the financial sector of an economy, governments and other stakeholders need to restore the system to ensure that trade flows can occur, and the economic objectives of growth, stability and general welfare in their territory can be fulfilled. An ill-functioning financial system is not conducive for trade flows therefore governments need to act in order to resuscitate the failing financial system and ensure that trade, especially across borders can take place.

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<sup>50</sup> WTO Working Group on Trade, Debt and Finance *Restoring Trade Finance: What Can the G-20 Do?* (2009) 3.

## **Chapter Three- Subsidies, WTO and International Trade**

### **3.1 Introduction**

International trade offers an opportunity for growth and for traders to maximize their welfare by exploring all possible markets for their goods and services.<sup>51</sup> China as an emerging player in international trade is a perfect example of how increased international business can bring about economic growth.<sup>52</sup> However in doing this, international regulations must be in place to ensure that the trading system is monitored and governed by an authority that will institute measures to protect sellers and buyers across national borders. This chapter will look into trade law and principles set out by the WTO to ensure an efficient and fair trading international system. The chapter will dwell briefly on the origins of the WTO and its function in global trade. It will go on to discuss the fundamental principles that the WTO advocates for. The core of the chapter will focus on subsidies and the WTO position on subsidies through exploring the GATT, GATS and specifically the SCM agreement.

### **3.2 WTO and International Trade**

#### **3.2.1 WTO overview**

The World Trade Organization (WTO) is an international body that deals with the establishment, monitoring and supervision of trade rules globally. The organization was borne out of the Marrakesh agreement in January 1995 as a successor to the General Agreement on Tariffs and Trade (GATT), which had been the only multilateral trading system rules since 1948.<sup>53</sup> Article I of the Marrakech agreement establishes the WTO. Article II goes on to give the scope of the WTO by saying “*The WTO shall provide the common framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal*

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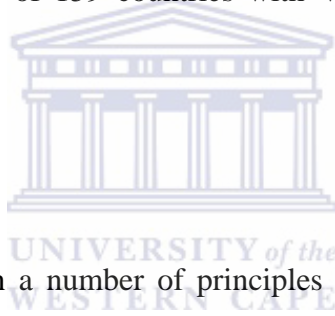
<sup>51</sup> Sun P & Heshmati A ‘International Trade and its Effects on Economic Growth in China’ (2010) Discussion paper 5151 *Institute for the Study of Labour* 5.

<sup>52</sup> Sun P & Heshmati A ‘International Trade and its Effects on Economic Growth in China’ (2010) Discussion paper 5151 *Institute for the Study of Labour* 5.

<sup>53</sup> See e.g. , WTO *The World Trade Organization* at [http://www.wto.org/english/res\\_e/doload\\_e/inbr\\_e.pdf](http://www.wto.org/english/res_e/doload_e/inbr_e.pdf) (accessed 15 November 2012).

*instruments...*<sup>54</sup> The role of the WTO is to ensure that trade is liberalized and supervised. The WTO presents a platform for the negotiating and formalizing of agreements between members. It also provides the arena for dispute resolution and the enforcement of WTO agreements by supervising and monitoring the adherence to trade agreements. Its function also places the organization in a cooperating role with the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) along with its affiliates. This function is to ensure coherence in global economic policy-making.<sup>55</sup>

The WTO's major areas of activity in a nutshell are: Trade negotiation, Implementation and Monitoring, Dispute settlement and Building Trade capacity. The overall aim of the WTO is to free up trade flows and above all else, ensure increase in welfare for the citizens of its member states. Since its commencement, the WTO has geared itself toward lowering trade barriers. As of March 2013 it had a membership of 159 countries with Vanuatu as the latest country to be granted accession to the WTO.<sup>56</sup>



### **3.2.2 WTO Principles**

The WTO philosophy is based on a number of principles that it aims to achieve in order to increase the welfare of its members' citizens. The major principle that is highlighted is the non-discrimination principle which requires members not to discriminate against "like" products irrespective of their origins. The principle of non-discrimination is two-fold and consists of the most-favoured nation and national treatment principles.<sup>57</sup>

The Most Favoured Nation treatment obligation requires that a country should not discriminate between two products originating from or headed for another country or give preference to a particular country's product while discriminating against another country's product that is like

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<sup>54</sup> Article II of Marrakesh Agreement.

<sup>55</sup> Article III of Marrakesh Agreement.

<sup>56</sup> See e.g. *WTO Members and Observers* at [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm) (accessed 19 November 2013).

<sup>57</sup> UNCTAD *Dispute Settlements* at [http://unctad.org/en/docs/iteiit30\\_en.pdf](http://unctad.org/en/docs/iteiit30_en.pdf) (accessed 19 November 2012).

the one preferred. The overall principle is that if a member country favours a particular good from a certain country that is also a member the same favour must be extended to all other member countries that are producing and selling that product. Article I of GATT 1994 outlines the MFN principle.<sup>58</sup>

The concept of “like products” can be expressed as products with similar or the same characteristics, end use and affected by the same tariff regimes of Members.<sup>59</sup> The likeness of a product can be accentuated by reviewing the *Spain-Unroasted Coffee* case.<sup>60</sup> This was a case in which Spain instituted a 7% duty on certain types of coffee from Brazil, namely Unwashed Arabica, Robusta and others while not imposing a duty on Columbian mild and other mild coffees. The Brazilian representative cited a contravention of Article 1.1 of GATT 1994 which is the non-discrimination principle and specifically the most favoured nation treatment obligation. The Spanish counterpart cited the same article but made reference to the “likeness” aspect of the article. Spain’s argument was that the types of coffee were different and the “like products” condition of the article was not entirely met. The panel that resolved the dispute cited the conditions that determine a “like product” as being affected by the same tariff regime, of similar characteristics and most importantly for that decision similar end use. The panel held that the end use of the coffee was for the purpose of drinking and hence all types of coffee were like products. It also cited that even though the preparation or processing of the types of coffee were different, the fact that most coffees are blends also meant that the genetic differences of the coffee beans were not substantial enough to constitute a deviation from the likeness and consequently a difference in tariffs.<sup>61</sup>

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<sup>58</sup> P Van Den Bossche *The Law and Policy of the World Trade Organisation: Text, Cases and Materials* 2 ed (2008) 370.

<sup>59</sup> P Van Den Bossche *The Law and Policy of the World Trade Organisation: Text, Cases and Materials* 2 ed (2008) 375.

<sup>60</sup> See eg WTO *Spain-Tariff Treatment of Unroasted Coffee* at [http://www.wto.org/english/tratop\\_e/dispu\\_e/80coffee.pdf](http://www.wto.org/english/tratop_e/dispu_e/80coffee.pdf) (Accessed 19 November 2012).

<sup>61</sup> See eg WTO *Spain-Tariff Treatment of Unroasted Coffee* at [http://www.wto.org/english/tratop\\_e/dispu\\_e/80coffee.pdf](http://www.wto.org/english/tratop_e/dispu_e/80coffee.pdf) (Accessed 19 November 2012).

The concept of “like” products also extends to services as outlined by Article II of the General Agreement on Trade in Services (GATS). The MFN treatment applies also to favours granted to “like” services and “like” service providers from different countries.<sup>62</sup> The GATS comes in to effect when a measure is instituted by a member and that measure affects trade in services.<sup>63</sup> Article I:2 of GATS defines trade in services as any form of trade within the four modes of supply namely: cross border- from the territory of one member into the territory of any other member, consumption abroad - in the territory of one member to the service consumer of any other member, commercial presence - by a service supplier of one member, through commercial presence in the territory of any other member and presence of natural persons by a service supplier of one member, through presence of natural persons of a member in the territory of any other member.

National treatment is the second major aspect of the non-discrimination principle. This principle is about treating foreign and domestic products and services equally. However, instituting duties on foreign products is not a violation of the non-discrimination principle as the equal treatment referred above is for foreign goods that have already entered the domestic market of a member. Article III:2 of GATT 1994 states that: “The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products”<sup>64</sup> An important distinction that arises with regard to national treatment is the difference between internal measures (which are prohibited according to Article III:2) and border measures which can be permissible. Another aspect of national treatment that is relevant to this study would be Article III:4 which expands on the internal measures by deeming national treatment as treatment no less favourable than that accorded to domestic like products.

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<sup>62</sup> P Van Den Bossche *The Law and Policy of the World Trade Organisation: Text, Cases and Materials* 2 ed (2008) 377.

<sup>63</sup> Article I:1 of General Agreement for Trade in Services.

<sup>64</sup> Article III:2 of General Agreement on Tariffs and Trade 1994.



This treatment no less favourable obligation is highlighted in Article XVII of GATS but naturally in that instance referring to like services and like service providers. The following bases have to be examined in order to determine the “likeness” of services or service providers: the characteristics of the service or service supplier (similar to GATT and “like” products), the classification and description in the United Nations Central Product Classification system (CPC) and the habits and preferences of consumers regarding the service or service supplier.<sup>65</sup> Article XVII:3 of GATS states that “Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.” This highlights the importance of determining whether a measure sets out to protect the competitiveness of the domestic services or service providers by creating a competitive disadvantage for services or service providers from other member countries.

Overall the WTO principles set out to promote freer trade, reduce barriers to market access, promote transparency which leads to improving predictability for potential businesses wishing to access the market opportunities in a new territory, promote fair competition and also importantly, encourage development and economic reform through liberalizing trade.<sup>66</sup> These core values of the trading system should remain the focus of all actions or measures instituted across all nations that affect trade. The WTO makes room for exemptions but these have to be carefully notified to all members by including such measures in the Member’s Schedule as articulated in Article XVIII of GATS under Additional Commitments. In an effort to progressively liberalize trade, the WTO through Article XIX of GATS makes provision for negotiation of specific commitments that should occur periodically.

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<sup>65</sup> P Van Den Bossche *The Law and Policy of the World Trade Organisation: Text, Cases and Materials* 2 ed (2008) 440.

<sup>66</sup> See WTO *Principles of the Trading System* at [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact2\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm) (accessed 20 November 2012).



### **3.3 Subsidies and the WTO**

The WTO in its attempt to reduce market access barriers and promote economic development through trade and trade negotiation must consider the interests of all contributors to trade. The last line of Article XIX:1 of GATS states that “The process shall take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations”<sup>67</sup> This means that in as much as reducing trade barriers is the goal of the WTO, it has to also consider the welfare of the domestic participants and how trade liberalization will affect their interests. For the purposes of this paper, Article III:8b of GATT can be cited to highlight the steps that trade law takes to accommodate measures taken by members to support their domestic producers through subsidies for instance. It states that “The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.”<sup>68</sup>

However it is important to note that the national treatment addressed by GATT does not necessarily encompass all trade aspects. The GATS affords members an opportunity to express the extent to which they commit to national treatment obligations through their Schedules of Specific Commitments under national treatment. A typical example of restraint that could be included in the schedule may speak about special subsidy given to local domestic service suppliers.<sup>69</sup> This leads to the need for determining what a subsidy is and how it should be employed within the trade law framework.

Article 1 of the SCM Agreement states that ‘...a subsidy would be deemed to exist if: (a)(1) there is a financial contribution by a government or any public body within the territory of a Member....,i.e. where: (i) a government practice involves a direct transfer of funds (e.g. grants, loans and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees)

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<sup>67</sup> Article XIX:1 of GATS

<sup>68</sup> Article III:8b of GATT 1994

<sup>69</sup> P Van Den Bossche (2008) *The Law and Policy of the World Trade Organisation: Text, Cases and Materials 2* ed 418

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits); (iii) a government provides goods or services other than general infrastructure, or purchases goods; (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or (a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and (b) a benefit is thereby conferred. 1.2 A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2.<sup>70</sup> Given that the SCM definition encompasses trade in goods and services, an analysis of the latter needs to be carried out for the purposes of this study. There is a need to establish to what extent the SCM definition can be used with regards to governmental support for services and specifically for the bailing out by government of financial service providers.

The SCM agreement makes provision for various facets of subsidies. For the purposes of this study, a brief discussion of Specificity and Remedies will be conducted. This will be carried out in order to contextualize subsidies with respect to government interventions for ailing financial systems. Article 2 aims to establish whether a subsidy is specific to an enterprise or industry or a group of enterprises within the jurisdiction of the granting authority.<sup>71</sup> Determination of specificity is conducted so as to ascertain whether a subsidy will be subject to countervailing measures or is an actionable subsidy.<sup>72</sup> Generally the remedies aspect of the Agreement refers to the measures that Members can take in order to address issues of adverse effects, serious prejudice and injury to their domestic industries as a result of a subsidy instituted by the granting authority of another Member. This is addressed under Articles IV and VII. This means that the granting of subsidies for a financial sector and to specific banks represents a form of subsidy meeting the Specificity criteria and can thus be regarded as actionable. Members, according to the remedies outlined in Article IV and VII can request that adverse effects be addressed or that countervailing duties be imposed to counter the negative effects of the subsidies in question.

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<sup>70</sup> Article I of SCM Agreement

<sup>71</sup> Article II of SCM Agreement

<sup>72</sup> Article I 1.2 of SCM Agreement

SCM categorizes subsidies into: prohibited subsidies, actionable subsidies and non-actionable subsidies. These are also referred to as using the ‘traffic light’ approach to subsidies with red, amber and green lights representing each type of subsidy respectively.<sup>73</sup> Article III describes prohibited subsidies as those that are contingent on export performance as well as those that are conditional upon the use of domestic goods over imported goods.<sup>74</sup> This prohibition clearly relates to the subsidies in the trade of goods and not directly to trade in services. Two exceptions can be highlighted and these are subsidies for agricultural products<sup>75</sup> and subsidies under GATS Article XV which are described as not being a set of rules or system but rather a negotiating mandate.<sup>76</sup>

Actionable subsidies are permitted subsidies provided that the institution of the subsidy does not cause adverse effects to the interests of other members.<sup>77</sup> Article V of SCM outlines these adverse effects as “...(a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994, in particular the benefits of concessions bound under Article II of GATT 1994; (c) serious prejudice to the interests of another Member.”<sup>78</sup> The serious prejudice outlined in Article V(c) of SCM is further explained in Article VI and is deemed to exist where “...(a) the total ad valorem subsidization of a product exceeding 5 per cent; (b) subsidies to cover operating losses sustained by an industry; (c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems; (d) direct forgiveness of debt, i.e. forgiveness of government-held debt, and grants to cover debt repayment.”<sup>79</sup>

It is under these actionable subsidies that a link can be construed to have significance with regards to impairment of trade flows through the subsidising of the financial industry which in

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<sup>73</sup> World Trade Report 2006 page 191

<sup>74</sup> Article III of SCM Agreement

<sup>75</sup> Article XII of AOA

<sup>76</sup> World Trade Report 2006 page 194

<sup>77</sup> Article V of SCM Agreement

<sup>78</sup> Article V of SCM Agreement

<sup>79</sup> Article VI of SCM Agreement

turn affects the provision of trade finance to international business participants.<sup>80</sup> Under actionable subsidies as highlighted above, Members that have experienced adverse effects or serious prejudice due to a subsidy by another member can request that the effects be addressed. In the event of a financial crisis, the lines between causing adverse effects and economic recovery can be very unclear. For example the US government gave support for its financial institutions during the crisis through the Troubled Asset Relief Programme (TARP) under the auspices of the Economic Stabilisation Act of 2008.<sup>81</sup> This programme gave the US Treasury the mandate to inject approximately US\$700 billion into the ailing industries, particularly the financial industry. The financial crisis, as mentioned in chapter 2 of this paper, brought about a drying up of credit and shortage of liquidity. This means that the support from the US Treasury afforded the subsidised firms an opportunity to resuscitate their business of providing funds to borrowers. These borrowers include businesses that are conducting international trade and are thus in need of trade finance and by virtue of that the bail-outs affect international trade flows.

Members that were not in a position to inject cash into their ailing financial systems were disadvantaged as the trade finance needed to conduct business internationally would have been lacking due to the crisis. However, this is where WTO law, especially under the SCM Agreement, needs to be revised for more clarity.<sup>82</sup> Two questions need to be addressed, namely: whether or not the subsidy distorted trade by creating an artificial competitive advantage for firms in the subsidized country as compared to their international competitors and whether or not the subsidies were purely instituted as government policy objectives to address economic recovery, for instance in the event of a financial meltdown or economic recession.<sup>83</sup>

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<sup>80</sup> Delimatsis P 'Of Bailouts and Rescue Measures:Subsidies in Financial Services'(2012) 24 *NCCR Trade Regulation Working Paper 2012/24* 3.

<sup>81</sup> Delimatsis P 'Of Bailouts and Rescue Measures:Subsidies in Financial Services'(2012) 24 *NCCR Trade Regulation Working Paper 2012/24* 4.

<sup>82</sup> Horlick GN & Clarke PA 'WTO Subsidies Discipline During and After the Crisis' (2010) 13 *JIEL* 869 872.

<sup>83</sup>Horlick GN & Clarke PA 'WTO Subsidies Discipline During and After the Crisis' (2010) 13 *JIEL* 869 872.

### **3.4 Subsidies: Trade in Goods vs Trade in Services**

The SCM Agreement covers subsidies in both goods and services. The underlying principles of GATT and GATS are similar in that both agreements aim to reduce trade barriers and promote non-discrimination.<sup>84</sup> However there are differences between their applications especially with regards to subsidies. The trade distortive nature of subsidies for trade in goods is less complex than that of trade in services. Subsidies for trade in goods mainly affect other Members when there is cross border movement of those goods thus affecting their domestic markets and subsequently creating potential for adverse effects and serious prejudice.<sup>85</sup> GATS, unlike GATT, makes consideration for more than one way in which a product can be traded internally. International trade in goods requires that a product crosses a border between two territories. GATS on the other hand, which deals with trade in services recognises that international trade in services can come in various forms namely cross border, consumption abroad, commercial presence and presence of natural persons.<sup>86</sup>

Cross border is the mode in which services are offered across territories from the territory of one member to another. This is the common type of supply with trade in goods. Consumption abroad refers to the supply of services offered by a territory when nationals of another territory consume its services. These can be in the form of tourists, patients and students leaving their country (even temporarily) to make use of services in another country. Commercial presence is when services are offered by subsidiaries or affiliates of foreign owned firms. The financial services industry is a typical example of this form of supply as many banks and other financial service providers, while commercially operating within a territory, may have their parent companies in other territories. The presence of natural persons refers to the literal use of service providers in a territory who actually come from another country. These may be in the form of health

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<sup>84</sup> Ahuja R 'Towards Developing Subsidy Discipline under GATS' (2005) 174 *ICRIER* 10.

<sup>85</sup> Ahuja R 'Towards Developing Subsidy Discipline under GATS' (2005) 174 *ICRIER* 10.

<sup>86</sup> See WTO at [http://www.wto.org/english/tratop\\_e/serv\\_e/cbt\\_course\\_e/c1s3p1\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm) (accessed 4 October 2013).

professionals or financial consultants who come into a territory outside their own to provide a service in another member's territory.<sup>87</sup>

Due to the various modes of supply for trade in services, it is more complex to determine the effect that subsidies for trade in services may have. Trade in services may be one of or a combination of the four modes of supply.<sup>88</sup> The WTO states that "1. Unlike the GATT, the GATS covers measures affecting both the product (service) and the supplier. 2. The definition of services trade covers not only cross-border supply, but three additional forms of transaction ("modes of supply"). 3. While quota-free entry ("market access") and national treatment are generally applicable obligations under GATT, they apply under the GATS on a sector-by-sector basis and only to extent that no qualifications ("limitations") have been scheduled."<sup>89</sup>

The complexities of trade in services with regards to the modes of supply emanate from the recognition of not only the product, as is the case in trade in goods, but also the supplier. Cross border supply is easily recognised as it involves the actual crossing of territories by a product. However, the other three present some complexity. The financial services sector could be used as an example to illustrate this. An investment bank in country A may be using as part of its products, derivatives from other countries to mitigate certain exposures. It may also have foreign based companies as part of its investment portfolio thus serving clients domestically and internationally. It also may have subsidiaries or affiliates in other territories and may occasionally send some of its consultants to other territories to conduct business. This typical example of a financial service provider shows how the firm's trade in services may meet the various modes of supply. This makes it very complex to determine trade flows and it blurs the lines dividing trade and competition distortion.<sup>90</sup> Furthermore it also makes it difficult to establish whether a subsidy can be classified as an export subsidy or production subsidy.<sup>91</sup> The

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<sup>87</sup> See WTO at [http://www.wto.org/english/tratop\\_e/serv\\_e/cbt\\_course\\_e/c1s3p1\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm) (accessed 4 October 2013).

<sup>88</sup> See WTO [http://www.wto.org/english/tratop\\_e/serv\\_e/cbt\\_course\\_e/c1s3p1\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s3p1_e.htm) (Accessed 15 May 2013).

<sup>89</sup> See WTO [http://www.wto.org/english/tratop\\_e/serv\\_e/cbt\\_course\\_e/c1s2p1\\_e.htm](http://www.wto.org/english/tratop_e/serv_e/cbt_course_e/c1s2p1_e.htm) (Accessed 15 May 2013).

<sup>90</sup> Ahuja R 'Towards Developing Subsidy Discipline under GATS' (2005) 174 *ICRIER* 2.

<sup>91</sup> Ahuja R 'Towards Developing Subsidy Discipline under GATS' (2005) 174 *ICRIER* 2.

theme of national treatment is very important for this study as it is a principle that requires all enterprises, both domestic and foreign in the same sector, to have access to subsidies, government support or bail-outs. National treatment can also be regarded as a strong deterrent for subsidies as it may become very costly for governments to have to subsidise entire service industries that may include foreign owned firms. The GATS however is based on a negotiating system meaning that the application of any principle is quite flexible and dependent on those aspects outlined in the Schedule of Commitments. Article XV of GATS states that “(1) Members recognize that, in certain circumstances, subsidies may have distortive effects on trade in services. Members shall enter into negotiations with a view to developing the necessary multilateral disciplines to avoid such trade-distortive effects. The negotiations shall also address the appropriateness of countervailing procedures. Such negotiations shall recognize the role of subsidies in relation to the development programmes of developing countries and take into account the needs of Members, particularly developing country Members, for flexibility in this area.

For the purpose of such negotiations, Members shall exchange information concerning all subsidies related to trade in services that they provide to their domestic service suppliers. (2) Any Member which considers that it is adversely affected by a subsidy of another Member may request consultations with that Member on such matters. Such requests shall be accorded sympathetic consideration.”<sup>92</sup> Once again the issue of adverse effects, serious prejudice or injury is mentioned. The onus is on the aggrieved members to seek consultations with the subsidising member. However, if the member that is instituting the subsidy is a developing country or even a LDC, and the subsidy is geared at developmental purposes, the subsidies may not be considered actionable as GATS XV stipulates. The move towards subsidy discipline has not been smooth and quick enough as most nations are yet to provide the information on their commitments to subsidy discipline by supplying the current subsidy programs they retain.<sup>93</sup> A lack of reliable information makes enforcing discipline difficult.

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<sup>92</sup> Article XV of GATS.

<sup>93</sup> Ahuja R ‘Towards Developing Subsidy Discipline under GATS’ (2005) 174 *ICRIER* 1-3.



Article XV of GATS draws a fine line between trade distorting subsidies and the need to uphold developmental objectives. The lacklustre provisions in this article make the subsidy discipline for trade in services a very subjective one that is highly dependent on members notifying each other and negotiating potential adverse effects. The developmental aspect is particularly emphasised in Article 27 of the SCM agreement which deals with the Special and Differential Treatment of developing country members of the WTO. This article allows state aid and subsidies by LDCs to be allowed for certain periods before aggrieved members can counter the effects of such subsidies. Article 27 of the SCM agreement recognises that certain subsidies may be in place in order to play an important role in development programmes for developing and least developed countries. These subsidies are thus given a 'sympathetic consideration' as GATS puts it, giving these countries time to meet their development objectives by using these subsidies. The SCM agreement however makes provision for member countries who may feel aggrieved by the subsidies to notify the WTO and seek consultations with the developing countries instituting the subsidies causing adverse effects.<sup>94</sup>

In light of the fact that there is an exemption afforded to developing countries using subsidies, it also brings about the issue of distinguishing between what according to trade rules will be deemed a subsidy and what will be regarded as public measures through regulatory policies that could have subsidy-like effects but may not be regarded as a subsidy under trade rules.<sup>95</sup> Understanding what constitutes a public measure or service may present further challenges as well. Krajewski points out that common understanding of what constitutes a public service has not been reached among member countries.<sup>96</sup> The reason for this is that the perceived role for the state is different across various countries due to their respective backgrounds or history and social and political value systems. He gives the example of how health care can be an acceptable

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<sup>94</sup> Article 27 of SCM Agreement.

<sup>95</sup> Ahuja R 'Towards Developing Subsidy Discipline under GATS' (2005) 174 *ICRIER* 1-3.

<sup>96</sup> Krajewski M 'Public Services and the scope of the General Agreement on Trade in Services (GATS)' (2001) *Centre for International Environmental Law* 3-4.



public measure in Europe whereas the same measure in the US, such as Obama-care, may not be as welcomed due to the perceived benefits from that state aid or measure.<sup>97</sup>

In the case of trade in goods, the countervailing measures could simply be in the form of duties so as to curb the adverse effects and further injury to a member. With regards to services trade, the countervailing measures may become more complex to institute as the determination of injury is not simply based on cross border movement of products but may be in various forms of supply which are more difficult to determine, making the determination of the extent to which they negatively affect the member's industry more complex. The WTO has adopted a 'positive list approach' in this regard. This means that in cases in which social, cultural, environmental and developmental goals are to be achieved by a generally recognised prohibited subsidy, exceptions could be made to accommodate the use of that subsidy for a greater good.<sup>98</sup>

### **3.5 Conclusion**

The definition of a subsidy is crucial for this study as it entails establishing whether a financial benefit was conferred to an industry or firm by a state. This benefit may be in the form of covering operating losses by enterprises or industries and forgiveness of debt. It is also important to establish whether this benefit meets the specificity criteria, thus determining whether a benefit is conferred to specific enterprises. The overall theme should be focused on avoiding social and economic problems for a nation. The use of subsidies for specific sectors or enterprises may have merit especially when instituted with the objective of economic recovery in times of crises. The relevant principles that can be extracted from the GATT, GATS and SCM agreements make provision for such subsidies. However the subsidy discipline in these agreements needs to be revised to truly reduce any trade distorting effects that such subsidies may cause. Other aspects such as regulatory policies and practices of monopolies are public measures that may not necessarily be subsidies but have subsidy-like effects bring about a need for a distinction

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<sup>97</sup> Krajewski M 'Public Services and the scope of the General Agreement on Trade in Services (GATS)' (2001) *Centre for International Environmental Law* 3-4.

<sup>98</sup> Ahuja R 'Towards Developing Subsidy Discipline under GATS' (2005) 174 *ICRIER* 2.

between a subsidy and public measures. A positive list approach is normally used thus attributing greater value to the positives than the negative effects of the subsidy.

Subsidies have in the past been categorized using a traffic light approach with red, amber and green denoting prohibited, actionable and non-actionable subsidies. Members can use countervailing duties to remedy the effects of actionable subsidies but will have to seek consultations with a member that has instituted prohibited subsidies. The consultative process for addressing the adverse effects or serious prejudice is not vigorous enough to ensure subsidy discipline. Firstly it requires members to provide all the information on the subsidies they currently maintain and this is a process that has not been carried out diligently. Secondly, the onus is on an aggrieved member to prove adverse effects, serious prejudice or injury. These aspects can be complex to research and quantify as well as being costly and time consuming. Exceptions have been granted for agricultural products and to developing countries that may intend on employing subsidies for developmental purposes for a stipulated time period. There has been lacklustre adherence to this by members thus questioning the issue of subsidy discipline.

The subsidy regime with regards to services has raised even more complexities. Firstly the modes of supply under services differ from trade in goods. Services trade can be cross border, consumption abroad, in the form of commercial presence and in the form of presence of natural persons. The effect of subsidies in this regard makes determining adverse effects and injury very difficult for an aggrieved member.

The bail-outs funds that were provided during the financial crisis of 2008-9 do constitute a subsidy under WTO rules as there were financial contributions made by governments to their ailing financial industries namely banks and insurance companies. The subsidies were specific in that they were made directly for certain enterprises hence meeting the specificity criteria that makes them actionable subsidies. This means that if there were foreign banks that were not subsidised and their governments sought action against the subsidies they could effectively be able to use the dispute settlement process as outlined in the agreement. This would entail proving injury, serious prejudice or adverse effects and possibly making use of countervailing measures to protect their interests.

## **Chapter Four- Governments' support for Trade**

### **4.1 Introduction**

Apart from creating a competitive and conducive market for trade, governments attempt to ensure that the economic and developmental objectives of a nation are addressed. One of these objectives is to provide an environment for a well functioning financial market. This financial market consists of allocation of resources between financial service providers and those seeking financial services and is regarded as the brain of the economic system.<sup>99</sup> As discussed in preceding chapters, the financial system of an economy is the means through which international business transactions take place. In the interest of maintaining trade flows, governments may intervene when crises arise that negatively affect the normal services that the financial sector provides.<sup>100</sup> Trade finance, which stems from within the financial services arena, is vital for trade to take place and thus governments will aim to ensure that the financial system is liquid and that credit is available for both exporters and importers.

This chapter will look into how subsidies, government support and bail-outs play a role in addressing the effects of the financial crisis on international trade. The chapter will focus mainly on relating the provisions outlined in WTO rules with government interventions that have taken place in recent times for the financial services industries. The EU framework on state aid will be the basis of this chapter. The EU affords the closest rules based system outside the WTO to address state aid for competition policy and trade relations. Governments' role in financial services and ultimately trade finance will be discussed from that view point. The US and EU governments will be mentioned as they have recently provided monumental bail-outs for their respective ailing financial industries. The chapter will also highlight provisions set by the respective rule making bodies with regards to state aid for firms in distress.

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<sup>99</sup> Stiglitz JE, Jaramillo-Vallejo J & Park YC 'The role of the State in Financial Markets' (1993) *World Bank Research Observer* 21 27.

<sup>100</sup> Stiglitz JE, Jaramillo-Vallejo J & Park YC 'The role of the State in Financial Markets' (1993) *World Bank Research Observer* 21 27.

## 4.2 Rationale for Government Support or State Aid

The financial crisis of 2007 and 2008 caused substantial disruptions to the financial system. These disruptions in flows between lenders and borrowers would subsequently affect the entire economy and this gave rise to the rationale for governments to rescue their financial systems.<sup>101</sup> According to Stiglitz *et al*, the failure of a single banking institution could have significant economic effects.<sup>102</sup> The reactions of the investors and depositors could trigger a wide spread banking crisis; for instance upon hearing, mere rumours of a bank's collapse. They may withdraw their funds or capital from that bank and even other banks thus creating a domino effect in the financial system. These effects may not only affect banks, but all other industries that require the use of banking services for their normal operations. This intricate and complex link of intermediaries in an economy through the financial system, also leads to contagion which amplifies the effects of a financial crisis.<sup>103</sup> The complexity arises for example from the use of credit default swaps and collateralised debt instruments and led to the collapse of big financial institutions such as Lehman Brothers and AIG (American Insurance Group) in the US.<sup>104</sup> The 'Too Big to Fail' doctrine emanates from the idea that there are banking institutions and other financial service providers that are too systemically significant and their collapse would have been catastrophic for the economy.<sup>105</sup>

The US government in this instance seemingly had grounds to intervene by bailing out these institutions. However, this rescue policy despite endeavouring to restore economic stability would upset tax payers as it was construed to be a reward for risk taking on behalf of the banks at the tax payers' expense.<sup>106</sup> Recent major governmental interventions include the US government bail outs of banks as well as the EU's bail out of the financial systems in Greece, Ireland,

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<sup>101</sup> Stiglitz JE, Jaramillo-Vallejo J & Park YC 'The role of the State in Financial Markets' (1993) *World Bank Research Observer* 23.

<sup>102</sup> Stiglitz JE, Jaramillo-Vallejo J & Park YC 'The role of the State in Financial Markets' (1993) *World Bank Research Observer* 23.

<sup>103</sup> Gai P & Kapadia S 'Contagion in Financial networks' (2010) *Working Paper 383 Bank of England* 5.

<sup>104</sup> Gai P & Kapadia S 'Contagion in Financial networks' (2010) *Working Paper 383 Bank of England* 5.

<sup>105</sup> Lastra R & Wood G 'The Crisis of 2007-09: Nature, Causes and Reactions' (2010) 13(3) *JIEL* 539.

<sup>106</sup> Stiglitz JE, Jaramillo-Vallejo J & Park YC 'The role of the State in Financial Markets' (1993) *World Bank Research Observer* 23-24.

Portugal, and Spain as well as most recently the bail out of the financial system in Cyprus.<sup>107</sup> Of most importance to this study, is the overall effect that these rescue measures had on international trade through trade finance and to what extent WTO law was adhered to.

### **4.3 European Guidelines on State Aid**

The European Union Treaty gives guidelines of how state aid practices should be conducted. There is a strong linkage between competition policy for its member states with special relation to state-aid, and WTO law under the Agreement on Subsidies and Countervailing Measures. The EU Treaty defines prohibited state aid as follows: “Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.”<sup>108</sup> Four aspects of state aid in this regard are highlighted in the treaty and these are namely: state aid granted through state resources, state aid that favours certain undertakings, state aid distorting or threatening to distort competition and state aid affecting trade between member states.<sup>109</sup> Ashurst’s Guide to State Aid points out a few key issues that have links to the definition of subsidies in the SCM agreement. The concept of favouring in the treaty refers to financial benefit conferred on firms that would not ordinarily be enjoyed given normal market forces.<sup>110</sup> This is very similar to the definition of subsidy in the SCM agreement. Article 87 of the EU Treaty is further explained by Ashurst to show that when there is a government benefit to all in a particular market, state aid does not exist. However, when that benefit is selective to a few firms or a firm in a market, state aid is deemed to exist. Relating this to subsidy rules from a WTO perspective shows similarities with the non-discrimination principle as well as the specificity concept in the SCM agreement.

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<sup>107</sup> See The Economist ‘The Cyprus Bailout: A better deal but still painful’ at <http://www.economist.com/blogs/charlemagne/2013/03/cyprus-bail-out> (Accessed 22 May 2013)

<sup>108</sup> EU Treaty at <http://eurex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:PDF> (Accessed 22 May 2013).

<sup>109</sup> Ashurst State Aid at [www.ashurst.com/doc.aspx?id\\_Resource=4631](http://www.ashurst.com/doc.aspx?id_Resource=4631) (accessed 22 May 2013).

<sup>110</sup> Ashurst State Aid at [www.ashurst.com/doc.aspx?id\\_Resource=4631](http://www.ashurst.com/doc.aspx?id_Resource=4631) (accessed 22 May 2013).

The effects of state aid according to the treaty will distort or have the potential to distort competition in the industry in which the *favoured* firm or firms operate. These effects also have cross-border characteristics and will affect international trade, in this case between EU member states.<sup>111</sup> Relating this to the post-financial crisis state aid given to banks and financial service providers brings into play the EU Commission's Guidelines on State-Aid for Rescuing and Restructuring Firms in Difficulty.

Paragraphs 4 and 5 of the Guidelines briefly point out that normal market forces should be upheld so that inefficient firms exit a market due to lack of competitiveness and that the institution of state aid should not become a normal practice as it is prone to abuse and does affect competition and trade across borders.<sup>112</sup> Paragraph 5 of the Guidelines document also refers to the "One Time, Last Time" principle which aims to limit the issuing of state aid to firms in difficulty to a once-off event that will not recur as this would otherwise be artificial survival of the firm in the market.<sup>113</sup> The Community Guidelines also define what a firm in difficulty is and contrasts rescuing and restructuring measures.

A firm in difficulty is defined in paragraphs 9 and 10 as being a firm that is no longer able to counter losses, which without government intervention, will lead to going out of business.<sup>114</sup> Such firms should have had more than half of their registered capital depleted, half of which should have been depleted in the preceding 12 months leading to the firm being the subject of collective insolvency proceedings.

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<sup>111</sup> Ashurst *State Aid* at [www.ashurst.com/doc.aspx?id\\_Resource=4631](http://www.ashurst.com/doc.aspx?id_Resource=4631) (accessed 22 May 2013).

<sup>112</sup> EU Commission *Guidelines on State Aid for Rescuing and Restructuring Firms in difficulty* at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:244:0002:0017:EN:PDF> (accessed 22 May 2013).

<sup>113</sup> EU Commission *Guidelines on State Aid for Rescuing and Restructuring Firms in difficulty* at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:244:0002:0017:EN:PDF> (accessed 22 May 2013).

<sup>114</sup> EU Commission *Guidelines on State Aid for Rescuing and Restructuring Firms in difficulty* at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:244:0002:0017:EN:PDF> (accessed 22 May 2013).

The definition of Rescue aid is outlined in paragraphs 14 to 16. Paragraph 14 gives the rationale for including both rescue aid and restructuring aid in the same legal framework on state aid. The reason for this is that both involve the use of state resources and usually complement each other on a practical level.<sup>115</sup> Rescue aid is meant to be temporary and reversible and purely instituted to allow a firm to remain a going concern till a plan for restructuring or for liquidation can be enacted.<sup>116</sup>

While Article 87 (1) of the EU Treaty clearly lists the criteria for incompatible state aid, namely: using state resources while favouring certain undertakings, distorting or threatening to distort competition and affecting trade between member states, it makes provisions for exemptions.<sup>117</sup> Of more pertinence to this study are articles 87 (2) b and 87 (3) b, c and e. Article 87(2) b, addressing those situations in which the common market will allow state aid says, “...aid to make good the damage caused by natural disasters or exceptional occurrences...” As no further explanation is provided for situations that constitute exceptional occurrences, an event like a global financial crisis may be included as such and so may justify the government interventions in the financial sector through the bail outs that have occurred throughout Europe in recent times. Article 87 (3) addresses scenarios in which state aid may be considered. Article 87 (3) b states, “...aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State...” It is thereby a sound justification for bail outs given that the state aid was instituted to address the financial crisis. It would have been deemed as being of interest to the member countries to rectify the effects of the crises especially citing economic stability and particularly trade finance.

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<sup>115</sup> EU Commission *Guidelines on State Aid for Rescuing and Restructuring Firms in difficulty* at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:244:0002:0017:EN:PDF> (accessed 22 May 2013).

<sup>116</sup> EU Commission *Guidelines on State Aid for Rescuing and Restructuring Firms in difficulty* at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:244:0002:0017:EN:PDF> (accessed 22 May 2013).

<sup>117</sup> EU Treaty at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:PDF> (Accessed 22 May 2013)



Part c refers to, “...aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest...”<sup>118</sup> This may mean that, pursuant to the establishment of common interest and where certain economic activities have been hampered, state aid may be considered as being compatible with the common market. In other words, given a situation in which economic activity has been harmfully affected by a financial crisis, state intervention through bail outs or aid, may be considered compatible provided that the aid would not adversely affect trading conditions by distorting competition or creating artificial competitive advantage for the beneficiaries of the aid.

The last consideration for state aid in the EU Treaty for state aid with relevance to this study is Article 87 (3) e. It refers to “...such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission...” This seems to mean that the Commission may use its discretion on whether to allow the institution of state aid endeavour by a government or not. In recent times the European Central Bank has most notably bailed out financial institutions in Greece<sup>119</sup> and Cyprus amongst others.<sup>120</sup>

The onset of the financial crisis that was triggered by the US mortgage crisis caused serious financial problems in the EU initiating a debt crisis. In an attempt to address state aid in times of crisis, the Temporary Community Framework for State Aid Measures to Support Access to Finance in current Financial and Economic Crisis was drafted to augment the Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty. This was drafted in 2009 after the 2008 publishing of the Application of State Aid rules to Measures taken in relation to Financial Institutions in the context of the current Global Financial Crisis.<sup>121</sup>

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<sup>118</sup> EU Treaty at <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:PDF> (Accessed 22 May 2013).

<sup>119</sup> ECB The Dynamics of Sovereign Debt Crises and Bail Outs at [http://www.ecb.int/events/conferences/shared/pdf/researchforum7/Uhlig\\_Harald.pdf?c7eb45ea771a5794368d40d58d8bc40c](http://www.ecb.int/events/conferences/shared/pdf/researchforum7/Uhlig_Harald.pdf?c7eb45ea771a5794368d40d58d8bc40c) (Accessed 14 June 2013).

<sup>120</sup> ECB Key Dates of Financial Crisis at <http://www.ecb.int/ecb/html/crisis.en.html> (Accessed 14 June 2013).

<sup>121</sup> Communication from the Commission at <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:016:0001:0009:EN:PDF> (Accessed 14 June 2013).



## 4.4 EU State aid rules & WTO Subsidy rules

A comparison of the EU framework on state aid and the WTO disciplines on subsidies can be conducted to extract the key issues that attempt to control the implementation of government intervention especially in times of economic difficulty. A critical analysis of the two frameworks shows certain similarities as well as differences that may lead to modifications of EU law and of WTO disciplines on subsidies in the future. This section will look into the various aspects of the relevant rules.

The first area with a clear difference is the definition of a subsidy or state aid. As mentioned earlier in this paper, a subsidy involves a financial contribution by government under WTO rules.<sup>122</sup> However this financial contribution is further expanded upon to relate to transfers of funds, loans and loan guarantees, and most importantly, even foregone income such as tax. The EU treaty on the other hand defines state aid as the granting of aid through state resources.<sup>123</sup> According to the EU rules, state aid will exist if there is a depletion of state resources for the purposes of the aid being given.<sup>124</sup> This means that the definition of subsidy under WTO rules is broader and encompasses more aspects of practices that could affect trade and competition. The EU rules are more relaxed as they only consider it to be state aid when there is a charge to the public account.<sup>125</sup> This means that the EU rules on state aid require a depletion of funds from the public account in the form of a transfer of resources in order for it to be deemed as state aid. The EU rules and WTO rules are similar when it comes to the concept of benefits conferred from WTO standpoint and advantages conferred from EU perspective. Both recognise that the recipient of the aid or subsidy must be better off than they would have been had it not been for the government support in the form of state aid or a subsidy.

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<sup>122</sup> Article 1 of SCM Agreement.

<sup>123</sup> Article 87 of EU Treaty.

<sup>124</sup> Ehlermann C & Goyette M 'The Interface between EU State Aid Control and the WTO Disciplines on Subsidies' (2006) 4 *ESTAL* 696 699.

<sup>125</sup> Ehlermann C & Goyette M 'The Interface between EU State Aid Control and the WTO Disciplines on Subsidies' (2006) 4 *ESTAL* 696 699.

WTO rules for subsidies categorise subsidies under prohibited, actionable and non-actionable subsidies. EU rules group the types of state aid as being incompatible, compatible and may be considered compatible. Article 87 (1) of the EU Treaty is directly similar to Article 3 of the SCM Agreement as they both describe the types of state aid and subsidies that should not be instituted by governments. While there is a strong similarity, the WTO rules go into more detail in Article 4 with regards to the action that aggrieved members may take to address the prohibited subsidies instituted by a member. Article 4 makes provision for aggrieved members to seek consultations with the member instituting the prohibited subsidy after which if the matter is not resolved, the aggrieved member may take it to the Dispute Settlement Body which will then settle the matter.<sup>126</sup>

The EC treaty is based on the premise that the Commission, as the highest authority, will act to resolve situations where state aid has been incompatible with the common market. The Commission will investigate the establishment of state aid before the aid is authorised whereas with the WTO discipline, the process is more reactive than proactive.<sup>127</sup> This shows that the WTO rules are broader as compared to the EU rules but the monitoring and regulation of the EU rules is more rigid and effective than the WTO disciplines on subsidies. This is because the EU has to make sure that its competition policy is sound and that the entire block is in accordance with that policy and this is done *ex ante*. WTO is more wide spread and concerned primarily with the trade distorting effects of subsidies across members' borders. However these distortions if they occur can only be dealt with *ex post* and after members have sought consultations for adverse effects and serious prejudice faced.<sup>128</sup>

Another key issue for the two regimes is that the EU Commission may authorise state aid, especially with regards to rescuing and restructuring firms in distress as per Article 87 (3)b, which according to the treaty would be discretionary, but may go against WTO principles of national treatment, most favoured nation and non discrimination, and subsidy rules. This means that an EU member state may face a dispute with a WTO member outside the EU given that the

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<sup>126</sup> Article 4 of SCM Agreement.

<sup>127</sup> Ehlermann C & Goyette M 'The Interface between EU State Aid Control and the WTO Disciplines on Subsidies' (2006) 4 *EStAL* 714.

<sup>128</sup> Article 7 of SCM Agreement.

process of giving aid to a firm in distress may have created international trade distortions that adversely affect that non-EU member.<sup>129</sup>

It is evident that both sets of rules have an overall theme of preventing trade distortions. However the EU rules also address the distortion of competition that would arise from a member granting state aid to an ailing industry or enterprise. Comments by Professor Jacques Bourgeois speaking at a conference session on state aid, subsidies and competition policy, point out that multilateral subsidy rules exist, in the form of WTO rules but there are no rules on competition.<sup>130</sup> The EU state aid rules aim to prevent distortions in trade and competition, while the WTO rules are only focused on combating trade distortion. This can be viewed as being of great significance especially when relating this to the bail outs in the financial services industry. Under WTO rules as mentioned above, the focus is on preventing distortions of trade across borders. This means that a subsidy that is granted to an enterprise in distress may be instituted to stimulate its recovery from a financial crisis for example, which would be acceptable under WTO rules, and could maintain the competitiveness it enjoyed prior to the crisis hence no trade distortions per se. However, this subsidy, in the form of a bail-out for example, may create competitive imbalances in the domestic market given that not all firms may have been afforded the privilege of getting a subsidy hence raising the issue of competition policy. The specific nature of the subsidy would disadvantage domestic firms that did not receive the subsidy. The EU rules on the other hand attempt to address that by maintaining stricter controls on competition and frowning on rewarding inefficient firms. However, what is crucial to note in this comparison is that the EU as a block is a member of the WTO which has individual countries within its sphere of influence. Trade matters among these countries would have to be addressed along with competition policy matters as cross border trade within the territory in this context can also be viewed as being domestic hence a need to deal with trade and competition policy together.<sup>131</sup>

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<sup>129</sup> Article 7 of SCM Agreement.

<sup>130</sup> See Session 7 State Aid, Subsidies and Competition Policy-what role for the WTO? at [www.wto.org/english/forums\\_e/public...e/session7\\_summ\\_e.doc](http://www.wto.org/english/forums_e/public...e/session7_summ_e.doc) (Accessed 15 October 2013).

<sup>131</sup> See Session 7 State Aid, Subsidies and Competition Policy-what role for the WTO? at [www.wto.org/english/forums\\_e/public...e/session7\\_summ\\_e.doc](http://www.wto.org/english/forums_e/public...e/session7_summ_e.doc) (Accessed 15 October 2013).

## 4.5 Application of rules during Financial Crisis

This section of the study will aim to discuss the practical issues that arose when governments intervened to rescue their failing financial systems during and after the financial crisis of 2008-9. It is through this discussion that the degree of adherence to the rules can be ascertained as well as the relevant shortcomings from the regulatory or rule making perspective as well as the monitoring and supervision. Horlick and Clarke made the observation that governments around the globe in general, were able to maintain discipline with regards to prohibited subsidies.<sup>132</sup> The rationale for this could have been that states were directly concerned with their domestic welfare and using export subsidies would be giving competitive advantage to other members. It is also important to note that this subsidy discipline was most adhered to generally because red light subsidies mainly comprise of export subsidies and import substitution.<sup>133</sup> The subsidies used to stimulate economic recovery fell into the domestic subsidies category thus falling into the amber light group making them actionable subsidies.<sup>134</sup> As discussed above, actionable subsidies afford an opportunity to aggrieved members who may have faced or may face injury, adverse effects or serious prejudice. Relating this to the bail out of banks in developed countries by their governments, a conclusion can be reached that WTO members that are able to, or were able to, prove injury or adverse effects to their own banking sectors could institute countervailing measures or seek removal of the subsidies via the dispute settlement process.

Developed members were the ones in a position to bail out their banks as they have relative to developing countries adequate capital that is more affordable, access to more technology and highly developed infrastructure.<sup>135</sup> Furthermore the liberalisation of financial services has created a situation in which due to the increasing openness to foreign financial institutions, there

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<sup>132</sup> Horlick GN & Clarke PA 'WTO Subsidies Discipline During and After the Crisis' (2010) 13 *JIEL* 861 862.

<sup>133</sup> Article 3 of SCM Agreement.

<sup>134</sup> Horlick GN & Clarke P 'WTO Subsidies Discipline During and After the Crisis' (2010) 13 *JIEL* 866 867.

<sup>135</sup> Lal Das B *The WTO Agreements: Deficiencies, Imbalances and Required Changes* (1998) 46.

has been an influx of banks and insurance companies from developed countries into developing countries.<sup>136</sup> This according to Dobson and Jacquet does not necessarily mean that liberalisation causes financial crises but it increases the risk of financial crises for a member's financial system as there is a greater exposure to global phenomenon and affects the domestic market's sovereignty.<sup>137</sup> In this regard it is evident that foreign subsidiaries will benefit from their parent companies getting bailed out during a crisis. The competitiveness of those subsidiaries may be deemed artificial and may adversely affect otherwise efficient domestic firms in that market in which they have a commercial presence. This raises the issue of competition distortion which the EU rules attempt to address. Trade rules may not have been violated when the bail outs were instituted but competition policy which is lacking from a WTO perspective has not been addressed creating imbalances especially between developed and developing members. Out of nearly 12 trillion dollars that the USA government put towards crisis relief, nearly 10 trillion went towards services, 75% of which was used for financial services.<sup>138</sup> This shows how relevant subsidy discipline in services is and needs to be addressed accordingly in the rules to correct the imbalances created. Subsidies in trade in services unlike in trade in goods are complex due to the different modes discussed earlier and using rules that are mainly relevant to trade in goods is not prudent. The difficulty in raising these issues from a developing member's perspective comes up mainly because of the cost intensive process of following the requirements of the dispute settlement process. The collection and analysis of the relevant information on the subsidy practices of the member instituting the bail outs as well as the information needed to prove injury or adverse effects for the aggrieved member is very costly and time consuming.<sup>139</sup> Lal Das recommends that this process be revised so that the fact gathering and analysis of subsidies become the duty of a panel that is part of the dispute settlement structure.<sup>140</sup>

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<sup>136</sup> Dobson W & Jacquet P *Financial Services Liberalization in the WTO* (1998) 32.

<sup>137</sup> Dobson W & Jacquet P *Financial Services Liberalization in the WTO* (1998) 32 47.

<sup>138</sup> Horlick GN & Clarke P 'WTO Subsidies Discipline During and After the Crisis' (2010) 13 *JIEL* 860.

<sup>139</sup> Lal Das B *The WTO Agreements: Deficiencies, Imbalances and Required Changes* (1998) 50.

<sup>140</sup> Lal Das B *The WTO Agreements: Deficiencies, Imbalances and Required Changes* (1998) 50 52.

## 4.6 Conclusion

It is in the best interests of governments to ensure that there is stability in their financial system. In the event of a financial crisis this may mean having to rescue and restructure firms that are in distress and whose collapse would worsen the crisis. The rationale to ensure a viable financial system is to allow trade to take place so as to recover from the crisis. In an attempt to offer support in the form of state aid or subsidies, governments should aim to prevent distortions in competition and international trade and make sure that the support offered is temporary and does not create artificial competitive advantage for the rescued firms.

The current WTO disciplines on subsidies need to be more stern and perhaps an adoption of the *ex ante* EU approach would be welcomed to avoid the consultation and dispute settlement process currently in place. Clear guidelines need to be given for the implementation of subsidies and state aid during times of economic and financial crises under WTO law. Overall there is no explicit contravention of laws when states support ailing industries and the remedies under the SCM agreement leave room for consultations for adverse effects and serious prejudice from aggrieved members. Subsidy discipline in trade in services is an area that was exposed by the financial crisis and needs reform so as to ensure derogations from distortions in trade and competition policy. The imbalances caused by the difference in wealth of members facing the costly dispute settlement process needs to be addressed by shifting the collection and analysis of subsidy practices to a dispute settlement panel thus allowing least developed members to consider consultations in the absence of costs and time consuming procedures to prove injury or adverse effects. Another area that needs reform under trade in services is the national treatment provision that is outlined in the GATS.<sup>141</sup> This provision requires that any treatment given to foreign suppliers within a territory should be no less favourable than that afforded to domestic suppliers. If commercial presence is a mode of supply for services then a bank that operates for example in the USA whose parent company is foreign to the USA should, given the national treatment, have access to the bail-out funding from the US government. This of course was not the case thus bringing into question the adherence to the national treatment provision.

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<sup>141</sup> Article XVII of GATS.

## **Chapter Five**

### **5.1 Conclusion**

Trade has been an important aspect of human survival and in recent times, international trade has been the key to achieving economic growth and moving towards financial stability. The WTO non-discrimination principles of most favoured nation and national treatment aim to reduce barriers to trade. Reduction in trade barriers leads to better welfare for producers of goods and services and consumers alike. Traders make use of the financial system to conduct their business and international traders do so through the use of trade finance instruments that are geared at hedging the risks of international business such as letters of credit, export credit insurance and guarantees. The global financial crisis of 2008 affected liquidity and credit in the financial services sector and this had an adverse effect on trade as trade finance instruments were affected leading to a sharp decline in international trade.

In order to restore trade finance in times of crisis, governments had to employ subsidies and state aid in the form of bail-outs to keep the ailing financial systems afloat. This brought into play the role of the WTO with special regards to subsidies and the disciplines thereof. The actions taken by states to address the financial crisis did in fact constitute subsidies or state aid according to the definitions in the SCM agreement as well as the EU treaty rules on State Aid. Financial contributions were made and benefits were conferred on specific firms in the financial sector. However, given that these actions were taken in order to aid in the economic recovery of an industry or group of firms, provisions in the relevant rules would allow the use of bail outs.

The WTO makes further provisions for remedying any injury to another member due to adverse effects and serious prejudice by allowing members to seek consultation with the member instituting the subsidies failing which the matter would be taken to the Dispute Settlement Body of the WTO. This process is thus dependent on members coming forward and proving those adverse effects caused by the subsidies. The WTO also makes provision for aggrieved members to put in place countervailing duties if the subsidies are deemed to be actionable under the SCM agreement.



On the other hand, the EU Commission takes a different approach by insisting that all state aid or subsidies be notified to the Commission so as to seek authorization thus stamping out any state aid that is incompatible with the common market. This *ex ante* approach ensures that any government support aimed at rescuing or restructuring firms in distress meets the applicable criteria and will not distort competition or trade.

Government bail-outs for banks during the financial crisis of 2008-9 constitute subsidies that were given to specific firms in the financial services industry. The criteria for subsidy according to the SCM agreement and state aid according to the EU state aid rules was met meaning the rules that govern subsidies and state aid can be applied to bail outs. The financial contribution from government in which a direct transfer of funds was made and benefit (or advantage according to EU treaty) was conferred satisfies those criteria. The specificity criteria was also met as the bail-outs were not open to all banks in distress but were specific to certain undertakings thus also meeting the definition of aid from an EU perspective and meeting the criteria for actionable subsidy from a WTO perspective. Instituting bail-outs therefore did not contravene any trade rules outright as that measure can be considered an amber light subsidy making it a subsidy that is actionable. Actionable subsidies make provision for disadvantaged members to seek consultations in a bid to remedy adverse effects or injury caused by the bail-outs. Presently no disputes have been brought forward to address the adverse effects that the bail-outs had on competition and international trade in the financial services arena. Least developed countries as well as developing countries are the members who would most likely not have been able to bail out their banks due to the lack of resources and that lack of resources would have also made the process of proving adverse effects and injury time consuming and expensive.

## **5.2 Recommendations**

It is important to note however that the bailing out of banks during the financial crisis exposed many deficiencies in the current legal framework especially citing the issues brought up by a lack of robust rules for subsidies in trade in services. The multi-modal supply framework of services presents various complexities in determining what should be a prohibited, actionable and non-actionable subsidy. This determination cannot be treated the same way as that of trade in goods due to the fact that goods trade is generally in one mode of supply namely cross border.



Services trade on the other hand must encompass cross border, commercial presence, consumption abroad and movement of natural persons. GATS and SCM agreement should modify the current rules to accommodate services more effectively.

Over and above the Schedule of Commitments that the WTO requests from its members, the WTO should follow the *ex ante* approach like that of the EU Commission which would allow the proactive investigation of members' subsidies before they are put in place. The major challenge with this may be the time frame needed to effectively conduct such a process given a financial crisis and the need to act fast to save the financial system, but this would ensure that the subsidies that do get implemented are in accordance with the principles of the WTO. This would also take away the need for consultations between members over adverse effects and serious prejudice. Another recommendation could be that of creating a dispute settlement panel that focuses on the collection of information on subsidy practices and analyses them on behalf of aggrieved parties who would have otherwise found the process too costly and time consuming. By doing this, more developing countries may have a voice in combating subsidies in services trade from developed countries.

The national treatment provision in GATS should be upheld as more liberalisation takes place in the financial services arena. If commercial presence is an identified mode of supply, it could be deemed discriminatory to give less favourable treatment to domestic based foreign subsidiaries. The use of domestic subsidies as was the case with the bail-outs should not then create a reward for inefficient firms or distort competition. This means that the WTO rules should not only focus on trade distortion but also develop competition policy along with national treatment principles.

The 'too big to fail' notion of large conglomerates may also require some reconsideration. A large corporation enjoys relatively larger market share and is very competitive. Therefore in times of financial crises such a firm should not just be bailed out due to the magnitude of its losses but rather a focus on the greater good should be exercised. In other words an in depth investigation into the negative impact of its demise for stakeholders versus the cost to stakeholders, especially to the state, of bailing it out should be conducted.

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