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## Foreign Subsidies, Distortions and Acquisitions: Can the Playing Field Be Levelled?

- **ABSTRACT:** *The world trade system's bedrock was laid more than seventy years ago and its architecture and structural principles were shaped by the societal paradigm of western democracies. The last two decades have seen the admission of various government-dominated economies to the WTO. This raised serious paradigmatic challenges. The system tailored to the needs and characteristics of western democracies proved to be inadequately equipped to frame government-dominated economies. This paper addresses one of these new challenges: government subsidies. First, it gives an overview of the status and treatment of product and service subsidies in WTO law and the gaps and shortcomings that result in the system's failure to address trade-distortive state aids. Second, it examines the European Commission's White Paper on Levelling the Playing Field as Regards Foreign Subsidies ("White Paper"), which ushers a comprehensive European response to the problems raised by subsidization in international trade. Third, the paper analyzes the WTO framework that governs and confines unilateral actions targeting foreign subsidies. Fourth, the paper makes a proposal for a complementary way to address the world trade system's "subsidies problem".*
- **KEYWORDS:** Countervailing duties, fair trade, GATS, GATT, subsidies, WTO.

### 1. Introduction

It is no exaggeration to say that the last few years have seen the paralyzation of the world trade system. Even though the Trump administration has been reprimanded for being the culprit, the root cause has been a set of real and genuine institutional

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problems and, hence, the WTO's "constitutional" crisis is expected to linger on after the expiry of President Trump's term of office. The world trade system's bedrock was laid more than seventy years ago (with the adoption of GATT 1947) and reached its full-blown institutional architecture three decades ago (with the establishment of the WTO in 1994). Its architecture and structural principles were shaped by the societal paradigm of western democracies, featured by a democratic political system based on democratic sovereignty, free market, autonomy of economic operators and a clear separation between the private and the public sector, which implied that private enterprises cannot be aligned to serve foreign policy aims.

This paradigm has lately come into conflict with the realities of the world trade club. The last two decades have seen the WTO's large-scale enlargement, with China joining in 2001, Saudi Arabia in 2005, Viet Nam in 2007 and Russia in 2012. While this was a very welcome development, which enhanced the strength of the world trade systems and turned the club of western democracies into a truly universal global trade system,<sup>2</sup> it raised serious paradigmatical challenges. The system tailored to the needs and characteristics of western democracies proved to be inadequately equipped to handle the problems raised by government-dominated economies.

This enlargement process not only brought some of the world's biggest economies into the club, it also extended the WTO to countries where the state has a central role in the economy. These polities have a different view on the relationship between the state and the market, the autonomy of state-owned enterprises and their (in)dependence from political governance, the relationship between rule of law and political hierarchy. "Government-dominated economies", as coined by this paper, are not planned economies but market-based economic systems where the government has a decisive formal and informal influence over market operators and informal governmental rules play a central role. Furthermore, these systems have a higher tendency to subsidize economic activities<sup>3</sup> and quite often this occurs via state-owned enterprises. Finally, intellectual property rights benefit from a lower level of protection and the legally recognized intellectual property rights are quite often not enforced via effective means. These traits challenge the system of WTO in various way. Some of these issues are simply not caught in the net of WTO law at all, while other, although covered by WTO rules, emerge with such a high intensity that the WTO cannot handle effectively.

This paper addresses one of these new challenges of the world trade system: government subsidies. It distinguishes among three categories of subsidies. Domestic subsidies, the most traditional category, are financial contributions granted to recipients who are located in the territory of the granting state. Foreign and transnational subsidies are extraterritorial state aids. Foreign subsidies are financial contributions provided to recipients located in a foreign country concerning activities to be pursued in that country. For instance, if the Chinese government grants a favorable (non-market-based) loan to a company established in the EU (a subsidiary of a Chinese company)

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2 See Nagy, 2019.

3 Lim, Wang and (Colin) Zeng, 2018; Hancock and Jia, 2019.

to submit a bid to a European public tender or to carry out an infrastructure project in one of the Member States, this will be a foreign subsidy. The term “transnational subsidy” refers to three-country scenarios where the granting authority, the recipient company and the economic impact are in different states: country “A” grants a financial contribution to a company located in country “B”, which, in turn, sells its products or services in country “C”.<sup>4</sup>

WTO law encompasses rather weak disciplines when it gets to subsidies. First, although product subsidies are regulated, these rules are incapable of handling lavish subsidization policies. The GATT and the Agreement on Subsidies and Countervailing Measures (“SCM Agreement”) address subsidies in relation to goods. In essence, these rules prohibit trade-restrictive subsidies and give member states a powerful tool to unilaterally offset the competitive advantage of subsidized products: they may impose countervailing duties. Nonetheless, the prohibition on subsidies is rather ineffective and hidden state aid (provided by state-owned enterprises via favorable contractual terms) remain largely under the radar. Furthermore, it is doubtful if extra-territorial subsidies<sup>5</sup> are covered by this regime at all. Second, service subsidies are not subject to any discipline. They are, in themselves, not prohibited and member states need to identify a GATS-conform legal basis to impose countervailing measures in the service sector. It has to be stressed that in WTO law “services” encompass a wide range of activities and the definition goes way beyond the meaning in EU law.<sup>6</sup> Notably, services, in addition to cross-border provision and consumption, also include the commercial and physical presence of foreign undertakings.<sup>7</sup> In EU internal market law, some of these scenarios may come under the rules of freedom of establishment<sup>8</sup> and free movement of capital.

This paper addresses the issue of subsidies in international trade against the above context. First, it gives an overview of the status and treatment of product and service subsidies in WTO law and the gaps and shortcomings that result in the system’s failure to address trade-distortive state aids. Second, it examines the European

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4 Cf. White Paper, p. 47 (“a foreign subsidy is a financial contribution benefitting directly or indirectly an undertaking in the EU, offering goods or services, or engaging in investments”).

5 Benitah, 2019.

6 Article 57 TFEU (“Services shall be considered to be “services” within the meaning of the Treaties where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons.”).

7 Article I(2) GATS (“For the purposes of this Agreement, trade in services is defined as the supply of a service: (a) from the territory of one Member into the territory of any other Member; (b) in the territory of one Member to the service consumer of any other Member; (c) by a service supplier of one Member, through commercial presence in the territory of any other Member; (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.”) & XXVIII GATS.

8 Article 49 TFEU (“Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.”).

Commission's White Paper on Levelling the Playing Field as Regards Foreign Subsidies ("White Paper"), which ushers a comprehensive European response to the problems raised by subsidization in international trade. Third, the paper analyzes the WTO framework that governs and confines unilateral actions targeting foreign subsidies. Fourth, the paper makes a proposal for a complementary way to address the world trade system's "subsidies problem."

## 2. Subsidies in WTO law

WTO law contains a comprehensive regime on subsidies in respect to trade in goods. Article VI GATT confines member states possibilities to provide product subsidies and empowers members that are hit negatively by such subsidies to adopt countervailing measures. The SCM Agreement contains a specification of these provisions. Nonetheless, these rules apply only to product subsidies, that is, aid provided to manufacturers. Furthermore, it is questionable if they apply to extra-territorial subsidies. The beneficiary of an extra-territorial subsidy may be located in the country where the goods are sold or in a third country where the goods are produced and from where they are exported. It is uncertain, if the GATT's regime and the accompanied SCM Agreement applies merely to subsidies provided to manufacturers located in the territory of the providing state.

No disciplines are in place concerning services (at least as to the export-oriented aspects of service subsidies, as the national treatment obligation may apply to subsidies and, hence, require member states to treat foreign and domestic enterprises located in their territory alike). While Article XV GATS contains an inbuilt mandate to negotiate and work out a regime on service subsidies, it establishes no discipline, aside from the duty of consultation with the members adversely affected.

The GATT prohibits only export subsidies for non-primary products, in Article XVI(4), and authorizes member states, in Article VI, to impose countervailing duties. Article XVI GATT, although confirming that export subsidies "may have harmful effects for other contracting parties", confines itself to obliging member states who engage in subsidization to notify other members and be ready to enter into discussion with the affected ones. Special rules are set out for agricultural subsidies (Agreement on Agriculture).<sup>9</sup>

The general prohibition of trade-restrictive product subsidies was introduced by a special WTO treaty, the SCM Agreement, which provides special rules on countervailing duties. The SCM Agreement defines three categories of subsidies: export and local content subsidies are *per se* prohibited (prohibited subsidies), other subsidies are prohibited only if they have proven adverse effects on the interests of another member. Some subsidies are pronounced *per se* lawful (non-actionable subsidies).

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<sup>9</sup> See Bartels, 2016.

The SCM Agreement has a broad scope of application owing to its wide definition of subsidies; still, it is doubtful if it applies to extraterritorial subsidies.

### *Article 1*

#### *Definition of a Subsidy*

*1.1 For the purpose of this Agreement, a subsidy shall 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 (referred to in this Agreement as “government”), 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);*

*(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.*

*(...)*

*2.3 Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.*

In principle, every specific financial contribution provided by the government or any public body that confers a benefit is considered to be a subsidy. State aids of general application are not caught in the net of the above disciplines: for a financial contribution to be covered by the SCM Agreement, it needs to be specific, that is, it needs to apply to particular enterprises, a particular sector or region (enterprise-specificity, industry-specificity, regional specificity). Prohibited subsidies (export and local content subsidies) are regarded specific *per se*. The term “financial contribution” is conceived broadly to encompass (at least theoretically) all benefits not available under free market circumstances.

The SCM Agreement's definition contains, however, two important loopholes that make the regime wanting in relation to government-dominated economies: the status of benefits provided by state-owned enterprises<sup>10</sup> and extra-territorial subsidies.

First, the application of the SCM Agreement to benefits provided by state-owned enterprises is not straightforward. Although a state-owned enterprise may be regarded as a "public body", this can be established only on a case-by-case basis. In *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, the Appellate Body<sup>11</sup> held that a public body is "an entity that possesses, exercises or is vested with governmental authority"<sup>12</sup> and "control of an entity by a government, in itself, is not sufficient to establish that an entity is a public body",<sup>13</sup> hence, the determination is subject to a rather demanding case-by-case analysis.

*Evidence that an entity is, in fact, exercising governmental functions may serve as evidence that it possesses or has been vested with governmental authority, particularly where such evidence points to a sustained and systematic practice. It follows, in our view, that evidence that a government exercises meaningful control over an entity and its conduct may serve, in certain circumstances, as evidence that the relevant entity possesses governmental authority and exercises such authority in the performance of governmental functions. We stress, however, that, apart from an express delegation of authority in a legal instrument, the existence of mere formal links between an entity and government in the narrow sense is unlikely to suffice to establish the necessary possession of governmental authority. Thus, for example, the mere fact that a government is the majority shareholder of an entity does not demonstrate that the government exercises meaningful control over the conduct of that entity, much less that the government has bestowed it with governmental authority. In some instances, however, where the evidence shows that the formal indicia of government control are manifold, and there is also evidence that such control has been exercised in a meaningful way, then such evidence may permit an inference that the entity concerned is exercising governmental authority.<sup>14</sup>*

The status and autonomy of state-owned enterprises is obviously not uniform in the member states, which feature extremely huge differences. The Appellate Body introduced a presumption in favor of independence. This may be a realistic assumption in some member states but, in others, it may appear to be credulous and repugnant to the reality. This presumption is apparently based on the WTO's original paradigm (western

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10 See Chiang, 2018.

11 Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WTO Doc. WT/DS379/AB/R (adopted Mar. 11, 2011).

12 Para. 317.

13 Para. 320.

14 Para. 318.

constitutional democracies) and turns a blind eye to the realities of government-dominated economies.

Second, there is some uncertainty as to whether the WTO regime applies to subsidies provided by a member state to a recipient located in the territory of another member state (extra-territorial subsidies). The depth of the problem is revealed by a recent decision of the European Commission, where the EU adopted countervailing duties on imports from certain Chinese enterprises located in Egypt for their receiving subsidies from the Chinese government. Led by the desire to ensure a firm legal basis, the Commission argued that the Chinese subsidies granted to Chinese enterprises located in Egypt could, on the basis of general international law, be regarded as subsidies provided by Egypt itself, hence, the regime on countervailing measures applied.<sup>15</sup>

Article 1 of the SCM Agreement defines “subsidy” as “a financial contribution by a government or any public body *within the territory of a Member* (referred to in this Agreement as ‘government’).”<sup>16</sup> Furthermore, Article 2.1. of the SCM Agreement makes a similar implicit reference: “[i]n order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as ‘certain enterprises’) *within the jurisdiction of the granting authority*, the following principles shall apply...”.<sup>17</sup> As to Article 1 one may forcefully argue that the phrase “within the territory of a Member” is related to the term “public body” and not the term “subsidy”, that is, this phrase simply confirms that solely subsidies provided by public bodies located “within the territory of a Member” are relevant. This is reinforced by the fact that in the brackets the text provides a shorthand for “a government or any public body.” If the phrase “within the territory of a Member” were aimed to provide a territorial confinement for the payment of the subsidy, it would be after the brackets. Furthermore, less convincingly, but one may still argue in respect to Article 2 that the phrase “within the jurisdiction of the granting authority” may embrace not only territorial but also personal jurisdiction, thus extending the scope of this provision to recipients located outside the territory of the member state concerned. Finally, Article 2.1. inserts the phrase “within the jurisdiction” into the definition of specificity but, at the same time, Article 2.3. provides that *per se* prohibited subsidies (that is, export and local content subsidies) are legally presumed to be specific, hence, they do not come under the definition set out in Article

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15 Commission Regulation 2020/776 imposing definitive countervailing duties on imports of certain woven and/or stitched glass fibre fabrics originating in the People’s Republic of China and Egypt and amending Commission Implementing Regulation (EU) 2020/492 imposing definitive anti-dumping duties on imports of certain woven and/or stitched glass fibre fabrics originating in the People’s Republic of China and Egypt. OJ L 189/1, 15.6.2020. para 699.; Commission Regulation 2020/870 imposing a definitive countervailing duty and definitively collecting the provisional countervailing duty imposed on imports of continuous filament glass fibre products originating in Egypt, and levying the definitive countervailing duty on the registered imports of continuous filament glass fibre products originating in Egypt. OJ L 201/10, 25.6.2020.

16 Emphasis added.

17 Crochet and Hegde, 2020.

2.1.<sup>18</sup> So it can be safely argued that at least transnational export and local content subsidies are caught in the net of the SCM Agreement, in addition to the prohibition of Article XVI(4) GATT on export subsidies for non-primary products.

All in all, the WTO's legal architecture appears to have various shortcomings, which make it incapable of confronting mass subsidization. The status of benefits provided by state-owned enterprises and the burden of proof faced by member states who want to have state-owned enterprises acts attributed to their home state open a wide playing field for government-dominated economies. The status of transnational subsidies is uncertain, while service subsidies are subject to no explicit WTO law discipline.

### 3. The EU's response to extra-territorial subsidies

On June 17, 2020, the European Commission adopted the White Paper on Levelling the Playing Field as Regards Foreign Subsidies. The White Paper responds to the danger posed by "state sponsored unfair trading practices, which disregard market forces and abuse existing international rules, with a view to building up dominance across various sectors of economic activity."<sup>19</sup> Non-EU Subsidies may promote foreign undertakings' existing activities in the EU, enable them to underbid their non-subsidized competitors at public tenders and help them to acquire EU companies. The White Paper identifies the major gaps in the international disciplines (and EU law mechanisms) on subsidies and proposes a set of rules to neutralize unfair trade practices and to ensure a level playing field in international trade and in the EU internal market.

Interestingly, the White Paper addresses merely extra-territorial subsidies and envisages no special rules as to product subsidies, even though, as noted above, subsidies provided by state-owned enterprises may raise serious issues in government dominated systems.

The White Paper confirms the Commission's position that EU (and international) anti-subsidy rules do apply to transnational subsidies (presumably because they are attributable to the state where the recipient enterprise is located). However, "trade in services, investment or other financial flows in relation to the establishment and operation of undertakings in the EU" are not covered by anti-subsidy disciplines.<sup>20</sup> "On the international level, the EU can bring litigation against a WTO Member for breaches of the SCM Agreement, in particular when a WTO Member grants subsidies, prohibited under that Agreement, or subsidies that cause adverse effects to its interests, and have the matter adjudicated by a WTO panel. However, the scope of application of the SCM Agreement is also limited to trade in goods. The WTO GATS contains an inbuilt

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18 Crochet and Hegde, 2020.

19 Crochet and Hegde, 2020, p. 4..

20 Crochet and Hegde, 2020, p. 10.

mandate to develop rules for subsidies in the area of trade in services, but thus far, no such rules have been developed.”<sup>21</sup>

The proposed measures are made up of three layers. A set of measures of general application is proposed to cover all foreign subsidies granted to economic operators established or active in the EU market (Module 1), which are meant to offset both product and service subsidies, and two special regimes governing foreign subsidies provided in the context of acquisitions of EU targets (Module 2) and bids in public procurement in the EU (Module 3). The term “acquisition” covers not only take-overs (where decisive control is obtained) but also to the acquisition of non-controlling minority rights or shareholdings and other transactions that result in “material influence” being acquired in an EU undertaking. As noted above, in the parlance of GATS, commercial presence is a mode of service supply, hence, subsidies granted in the context of acquisitions may qualify as service subsidies. The decisive trigger in all three modules is that the subsidy is foreign, that is, it is provided by a third country. The proposed measures are modelled after EU state aid rules, which apply solely to state aids granted by Member States<sup>22</sup> and, hence, do not cover subsidies provided by foreign governments. The term “subsidy” has to be conceived broadly; in the context of acquisitions, in addition to the benefits explicitly linked to the transaction, it also covers indirectly related aids (e.g. measures that enhance the acquirer’s financial strength and, thus, facilitate the acquisition).

The operation of Module 1 is based on *ex post* investigations, while Modules 2 and 3 create an *ex ante* system and a duty of notification. Hence, the measures to be adopted as a result of the investigation slightly differ as to the three modules. Nonetheless, they are all “redressive measures” aimed to obviate the repercussions of the foreign subsidy and could range from structural remedies and behavioral measures to re-payment.

The investigation extends to three core issues: existence of a subsidy, distortion in the internal market and the subsidy’s redeeming virtue, that is, “the positive impact that the supported economic activity or investment might have within the EU or on a public policy interest recognised by the EU.”<sup>23</sup> If a distortive subsidy has a redeeming virtue, the distortion and the positive effects have to be balanced. The EU’s public policy objectives include, for instance, the creation of jobs, climate neutrality goals, environmental protection, digital transformation, security, public order, public safety and resilience.

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21 Crochet and Hegde, 2020, p. 10.

22 According to Article 107(1) TFEU: “1. Save as otherwise provided in the Treaties, 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 internal market.” (emphasis added)

23 Crochet and Hegde, 2020, p. 14.

#### 4. WTO law concerns

The White Paper is a novel and unprecedented attempt to address extra-territorial subsidies and may call for the interpretation of various aspects of WTO law, which so far have simply not been tested in practice.

As to trade in goods, there are two important WTO law restraints that need to be considered. First, Article VI GATT permits countervailing duties only up-to the amount of the subsidy. Second, Article 32.1 of the SCM Agreement rules out unilateral measures against subsidies beyond the ones allowed by the Agreement itself.

Article VI GATT authorizes member states to adopt anti-dumping and countervailing duties. Absent this provision, members would not be allowed to adopt such measures, as these may go counter to their tariff-bindings<sup>24</sup> and the MFN principle.<sup>25</sup> As a corollary, they may adopt countervailing (and anti-dumping) measures only to the extent enabled by Article VI, which, in turn, caps countervailing duties at the amount of the subsidy.

*3. No countervailing duty shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular product. The term “countervailing duty” shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise.*

Second, Article 32.1 of the SCM Agreement rules out unilateral measures against subsidies that are not compliant with the Agreement.

*No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.*

This may raise problems of interpretation. Arguably, the above provision might prevent members from adopting unilateral measures in response to transnational subsidies (except they can attribute the subsidy, on the basis of international law, to the state where the recipient is located), if the meaning of “subsidy” in Article 32.1 is not equated with the definition in Article 1. According to this line of interpretation, Article 1 defines the subsidies that may be potentially prohibited under the SCM Agreement, implying

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24 Article II GATT.

25 Article I GATT.

that subsidies not coming under this definition qualify as permitted subsidies. This is corroborated by Article 32.1's reference to the SCM Agreement as an interpretation of the GATT ("in accordance with the provisions of GATT 1994, as interpreted by this Agreement."). This suggests that the SCM Agreement is an authoritative and binding interpretation of Article VI GATT and, hence, subsidies not covered by the Agreement are not covered by Article VI GATT either.

On the other hand, the exhaustive nature of the SCM Agreement is falsified by the fact that the Agreement contains a detailed list of expressly permitted subsidies (in Part IV), labelled as "non-actionable." Why did member states permit transnational subsidies by means of a narrow definition of "subsidy" and not by a specific rule, if they really wanted to exempt them? The language and structure of the SCM Agreement suggests that transnational subsidies were left out because they did not exist (or at least they were not widespread) at the time and the drafters' imagination did not extend to them. This is reinforced by the footnote attached to Article 32.1 of the SCM Agreement (footnote 56), confirming the intention that the Agreement was not meant to be the exhaustive regulation of countervailing measures adopted in response to subsidies.

*This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate.*

Taking the above into account, it seems to be more plausible that by adopting the SCM Agreement, member states did not give up the authorization conferred on them by Article VI, which applies to subsidized products at large, irrespective of whether the source is a domestic or an extraterritorial subsidy. It would be contradictory to argue that Article 32.1 of the SCM Agreement uses the term "subsidy" in a wider sense than the definition of Article 1 that sets out the very scope of the Agreement. If the scope of the Agreement does not extend to a subsidy, none of its provisions should apply to it, including Article 32.1.

While WTO law contains no disciplines on service subsidies, it sets out limitations on unilateral measures adopted in response to them. The most important question is whether these countervailing measures may go counter to National Treatment as provided in Article XVII GATS and the Agreement on Government Procurement.

Because extraterritorial subsidies very likely target foreign or foreign-owned companies, countervailing measures adopted in response to them may amount to *de facto* discrimination or a restriction on market access. Of course, these provisions of the GATS are relevant only if a member state made the corresponding commitments under its schedule. However, the EU would have a good case in this regard. First, in the decisional practice of the DSB, asymmetric impact does not equal discrimination and, hence, in itself, does not violate the requirement of National Treatment. To prove such a violation, the complainant needs to prove that the distinction is based

on national origin and asymmetric impact, in itself, does not prove that. For instance, the WTO Dispute Settlement Body's decision in *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes* suggests that asymmetric impact, at least in itself, may not be sufficient to establish discrimination: it needs to accrue from national origin.<sup>26</sup> Furthermore, legitimate regulatory distinctions do not violate National Treatment. As to both of these arguments it is decisive that the EU has a very comprehensive and rigorous state aid regime in place and the treatment of foreign subsidies is modelled after this regime. In fact, in the EU there is an inverse discrimination in place: EU member states are prohibited from granting subsidies restrictive of competition in the internal market, while foreign states are not. The White Paper merely envisages extending to foreign governments the rules that, for the time being, apply solely to EU Member States. This circumstance also justifies a reference to the GATS' General Exceptions. Article XIV(c) GATS exempts measures aimed to comply with internal regulations. EU state aid law, which is part of EU competition law, may be regarded as such a regulation. As EU state aid law applies to intra-EU transactions, no arbitrary or unjustifiable discrimination or disguised restriction on trade may emerge.

*Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:*

(...)

*(c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement.*

The Agreement on Government Procurement contains no general exceptions, however, a “legitimate regulatory distinction” test may be reasonably applied here.

Of course, in terms of WTO law assessment, the devil will lie in the details. The validity of the claim that the extension of EU state aid rules to extra-territorial subsidies is not discriminatory will ultimately depend on how this regime is shaped. There are some points that should be mentioned here. On the one hand, EU state aid rules will not be applied in their entirety but will serve only as a model for the treatment of foreign subsidies. There may be some minor differences, for instance, the block exemption regulations may not apply. On the other hand, although it could be argued that this is due to the different characteristics of domestic and extra-territorial subsidies, the application and enforcement of these rules will be different, the same as the remedies available.

<sup>26</sup> See e.g. Appellate Body Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WTO Doc. WT/DS302/AB/R (adopted Apr. 25, 2005), para 96.

## 5. Alternative means to address excessive subsidization: proposal for an offensive strategy

In the wake of the emergence of government-dominated economies, most trading nations reacted to the increasing level of subsidization via defensive measures. Some of these were traditional regulatory measures well-known for the world trade system, such as adopting countervailing duties on subsidized import products. As seen above, this policy, framed by the SCM Agreements, was extended to transnational subsidies, where the recipient of the aid is located outside the providing country and ships the subsidized products to a third country. Some other measures tried to use novel, creative ways to react. An example of these is the US tariffs on aluminum and steel, which hit a major blow to WTO law.<sup>27</sup> Nonetheless, one aspect of the subject has been largely overlooked: subsidies are reprehensible not only because they distort competition in the targeted markets, but also because they should be made equally available to foreign enterprises settled in the territory of the granting member state. National treatment is a central principle of both trade in goods and services. Even though GATS National Treatment is conditional in the sense that it is subject to the member's schedule of commitments, if a commitment was entered and state aid was not excluded from it, the requirement of national treatment extends to subsidies as well.

Although the GATS contains no explicit disciplines on subsidies, it does apply to them.<sup>28</sup> Article I(1) provides that the GATS applies to “measures by Members affecting trade in services” and, as confirmed by the *travaux préparatoires*, subsidies are just that.<sup>29</sup> This also follows from the fact that the GATS contains rules on subsidies in Article XV: although this provision has no practical significance, as it provides merely for consultation, it corroborates that the GATS itself applies to subsidies. As a corollary, GATS provisions, if not specifically excluded, apply to service subsidies. These include Article II on Most-Favoured-Nation Treatment, Article III on Transparency, Article VIII on Monopolies and Exclusive Service Suppliers and last but not least Article XVII on

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27 Nagy, 2019.

28 Note that “services supplied in the exercise of governmental authority” (“any service which is supplied neither on a commercial basis, nor in competition with one or more service suppliers.”), as provided in Article I(3)(b)(c) GATS, as well as, traffic rights and services directly related to the exercise of traffic rights, as provided in Article 2 of the Annex on Air Transport Services, are not covered by the GATS.

29 GATT Document MTN.GNS/W/164, 3 Sep. 1993 “Scheduling of Initial Commitments in Trade in Services: Explanatory Note”, para 9-10 (“9. Article XVII applies to subsidy-type measures in the same way that it applies to all other measures. Article XV (Subsidies) merely obliges Members to “enter into negotiations with a view to developing the necessary multilateral disciplines” to counter the distortive effects caused by subsidies. Therefore, any subsidy which is a discriminatory measure within the meaning of Article XVII would have to be either scheduled as a limitation on national treatment or brought into conformity with that Article. Subsidy-type measures are also not excluded from the scope of Article II (M.f.n.). An exclusion of such measures would require a legal definition of subsidies which is currently not provided for under the GATS.”)

National Treatment. The language of the GATS also suggests such a conclusion, as the GATT excludes subsidies from the scope of national treatment in Article III:8(b) and there is no such exclusion in the GATS. This implies that without such an exclusion subsidies are covered by the principle of National Treatment.

All in all, once a subsidy, let it be a favorable loan or a bailout, affects trade in services, it is covered by the GATS, including the principle of National Treatment. Consequently, WTO members are, in principle, expected to treat domestic and foreign services and service providers even-handedly concerning subsidies, subject to the terms of their respective schedules of commitments.

*Article XVII GATS*

*1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.*

*2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.*

*3. 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.*

Member states are not obliged to take measures outside their territorial jurisdiction,<sup>30</sup> however, within their territory they are subject to National Treatment. This implies that there is no legal basis to extend subsidies provided to an enterprise in a foreign market. On the other hand, contrary to extra-territorial subsidies, domestic subsidies are governed by the principle of National Treatment. For instance, if China subsidizes a Chinese company located in the EU, Article XVII GATS does not apply; however, if China subsidizes companies located in China, this benefits has to be extended to the enterprises of other WTO members which are located there. Commercial and physical presence are two of the four modes of supply of services, hence, investments are covered by the GATS. Commercial presence is defined by Article XXVIII(d) GATS as “any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of

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30 GATT Document MTN.GNS/W/164, 3 Sep. 1993 “Scheduling of Initial Commitments in Trade in Services: Explanatory Note”, para 9-10 (“10. There is no obligation in the GATS which requires a Member to take measures outside its territorial jurisdiction. It therefore follows that the national treatment obligation in Article XVII does not require a Member to extend such treatment to a service supplier located in the territory of another Member.”)

a branch or a representative office, within the territory of a Member for the purpose of supplying a service.”

Of course, the GATS’ National Treatment obligations are conditioned on the provisions of the individual member’s schedule of commitments, which may contain horizontal limitations or exclude or confine national treatment in individual sectors. Hence, the effectiveness and practical relevance of the above constructions is conditional. Nonetheless, absent exclusions and limitations, National Treatment fully applies to subsidies and may be a useful tool to counteract excessive subsidization policies.

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