Goettingen Journal of International Law 2 (2010) 2, 423-435

New Protectionism – How Binding are International Economic Legal Obligations During a Global Economic Crisis?

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doi: 10.3249/1868-1581-2-2-Hobe

Abstract

The global financial crisis has not only instigated states to enact a wide range of protectionist measures, by which they seek to protect their economic interests, but it also forms the background against which possible justifications regarding protectionist measures have to be discussed and measured. The present article examines recent examples of protectionist measures and discusses, to what extent such measures may be justified by rules stemming from the WTO legal regime or international investment law in general. The authors focus on the concept of "economic necessity", which is enshrined in Art. 25 of the ILC Articles on State Responsibility and which has taken on even greater importance due to the Argentina investement law cases. They furthermore explore, whether this concept has been recognized by the WTO legal regime and/or bilateral investment treaties (BITs) and what criteria would have to be met so that a state could successfully rely on necessity to justify its actions in times of an economic crisis.

A. Introduction

The current financial crisis has instigated national programs for the promotion of national economies to an extent previously unknown. Almost no state could resist the temptation of creating such programs and intervening in the economic process. An environmental bonus for buying new cars and other subsidies as well as the creation of barriers to trade or subsidies on exports are only some of the many different protectionist measures that governments carried out. The same is true for many state measures in the banking industry.

It is well known that the history of international economic relations has witnessed major and minor crises. The worldwide economic crisis of 1929-1933 with its borderless protectionist measures as well as the history of countless uncompensated expropriations of foreign investment during the 20th century in particular have, however, contributed to the creation of international rules in the areas of trade and the protection of foreign investment. These rules are of a public international law character, and are found within the WTO System and almost 2700 bilateral investment treaties

(BITs)[1]. They limit a government's freedom to enact protectionist measures. It is of paramount interest to observe to what degree states in crisis situations demonstrate their readiness to overstep existing legal boundaries and violate their public international law obligations. But for a system which – irrespective of existing enforcement mechanisms – heavily relies on the willingness of the states to observe the rules and to obey to the rule of law, voluntary compliance is of key importance. This is particularly true for the current crisis which has been called the most serious crisis of its kind since the Great Depression in the 1930s.[2] The international economic system can be regarded as a reliable system only if the rules are effectively observed at all times. In the absence of effective observation of the rules in a time of crisis, one may have doubts as to the effectiveness of the whole body of rules within this system.

A crucial question in this context concerns the existence of general exceptions to the existing rules which are meant to justify violations for reason of economic emergency situations. This question will likely be asked very soon in the context of the already existing mechanisms for dispute settlement, especially in the area of investment protection.

In the following, a number of observations will be made, first regarding the diverse protectionist measures which have been in the focus of attention in recent months (B.). Second, this paper will raise the more general question as to whether the particular situation of a global financial crisis may exceptionally give leeway for states to adopt protectionist measures (C.). In this context, we will briefly discuss to what extent the respective systems of rules, WTO law, and international investment law recognize such exceptions. The observations shall finally be summarized. (D .).

B. Areas of New Protectionism – Some Examples

In view of the imminent danger of protectionist measures to combat the current financial crisis, the Australian Minister for Trade, Simon Crean, had stated the following:

1 UNCTAD, 'Recent Developments in International Investment Agreements (2008 - June 2009)', IIA Monitor No. 3 (2009), available at http://www.unctad.org/en/docs/webdiaeia20098_en.pdf (last visited 14 June 2010).

2 See with further references S. Wilske, 'Crisis? What Crisis? – The Development of International Arbitration in Tougher Times', *Contemporary Asia Arbitration Journal* (2009) 187.

> "We must re-commit ourselves to renouncing protectionism, be it trade or financial. To ensure we get the biggest bang for our buck, we need to ensure the benefits of our stimulus and rescue packages can flow across borders, so that all can benefit from the action we take individually. G20 leadership by example is essential to create a virtuous cycle in which countries lift each other up rather than pull each other down through protectionism".[3]

Not long time ago, on 15 November 2008, at the peak of the financial crisis, the G20 States formulated their intention to follow exactly this approach and to avoid protectionism. Ever since, however, numerous states – among them the majority of the G20 States – have applied protectionist measures.[4]

Governments have undertaken a great variety of legally problematic measures in response to the current crisis. Industrial nations especially have been using subsidies. One very prominent example of an environmental subsidy was the so-called "scrapping bonus" - a governmental measure to serve the purpose of stimulating the sale of automobiles and, thus, protect this industry from extreme disruption. Such measures for the protection of automobile industries have reached a volume of 48 billion US Dollars worldwide.[5] Because the German scrapping bonus did not differentiate between German and foreign producers, a possible discrimination contrary to international trade and investment laws was not present. The United States has also made such a program, which seems to be consistent with the prohibition of discrimination in international economic law. Other states have followed different roads in this respect.[6] There has been a report that Japan, due to required bureaucratic hurdles, effectually excluded foreign

3 S. Crean, 'Protectionism and the Global Economic Crisis – the Role of Trade in the Response', in R. Baldwin & S. Evenett (eds), *The Collapse of the Global Trade, Murky Protectionism and the Crisis: Recommentations for the G20* (2009), available at http://www.voxeu.org/reports/Murky_Protectionism.pdf (last visited 14 June 2010), 13-14.

4 E. Gamberoni & R. Newfarmer, 'Trade Protection: Incipient but Worrisome Trends', in R. Baldwin & S. Evenett (eds), *The Collapse of the Global Trade, Murky Protectionism and the Crisis: Recommendations for the G20* (2009), 49.

5 *Id.*,50.

6 See *e.g.* R. Baldwin & S. Evenett, 'Introduction and Recommendation for the G20', in R. Baldwin & S. Evenett (eds), *The Collapse of the Global Trade, Murky Protectionism and the Crisis: Recommendations for the G20* (2009), 50.

producers from the privileges of such a bonus. In Korea, it is not the rules for the scrapping bonus which excludes foreign producers, but rather non-tariff trade barriers which result in only a limited number of foreign cars profiting from the bonus.

While the US "scrapping bonus" system seems unproblematic, another measure taken by the United States has received great international attention. The People's Republic of China understood the punitive customs of 25 percent on Chinese car wheels as a "serious act of trade protectionism".[7] Although there may be no doubt that this measure has a protectionist character, one must take into account that China's entry into the WTO brought about special rules allowing for an increase of tariffs in case of imports of extremely cheap products endangering a whole branch of an industry.[8] Arguably, the American measures could be justified by these specific circumstances.

Many other states enacted protectionist measures in response to the current crisis. For example, Russia increased customs duties for used cars, Ecuador increased tariffs for more than 900 types of goods, and Argentina introduced non-automated license procedures concerning imports of parts for cars, televisions, shoes, and other products.[9] Finally, India enacted an import ban on Chinese toys and China banned imports on Irish pork and various other European products.[10]

A third range of problematic measures is contained in packages for the stimulation of the economy which confine the financial support to home producers. As these are often linked to environmental concerns, such measures can in part be designated as "green protectionism".[11] In the United States' package for the strengthening of the economy, for example, the subsidies for the producers of specific progressive batteries would be provided under the sole condition that these producers were in the United States.

Finally, one could mention export subsidies. For example, two of the G20 States are considered to subsidize the export of their agriculture

7 See *Frankfurter Allgemeine Zeitung* of 15 September 2009.

8 See the agreement on the entry of the Peoples Republic of China into the WTO.

9 Baldwin & Evenett, *supra* note 6, 4.

10 For example: for Belgian chocolate, Italian Brandy, Dutch eggs or Spanish milk products, see Baldwin & Evenett, *supra* note 6, 4.

11 S. Evenett & J. Whalley, 'Resist Green Protectionism or Pay the Price at Copenhagen', in R. Baldwin & S. Evenett (eds), *The Collapse of the Global Trade, Murky Protectionism and the Crisis: Recommendations for the G20* (2009), 93-97.

products when these products enter the world market. Measures in the area of procurement and, of course, the bailouts for banks[12] complete the picture. How is it possible that some banks (for example Fannie Mae and Freddie Mac) were rescued while others (Lehman Brothers) were not? Is this discriminatory to foreign shareholders of the Lehman Brothers?

Accordingly, one can state the following: The various measures show that the special situation of the economic crisis brings about state measures which may not be in conformity with international obligations. The World Bank has identified at least 74 problematic measures in the area of trade. Among the states applying these measures are 17 of the G20 States.[13] This can be seen as a relatively clear tendency for states, in times of crisis, to think first about serving their own economic interests, irrespective of possible prohibitions under international trade or investment law. It recalls the old but crucial observation that politicians' voters sit in their own countries, not abroad. While it may go too far to say that the crisis brought about a change from a system of free market to a system of managed economy,[14] one can well argue that the demonstrated degree of market intervention, much of which was motivated by protectionist intentions, was quite remarkable. Such findings may, however, be premature should international law regard such "emergency measures" as justified by reference to a specific circumstance precluding wrongfulness, namely "necessity".

C. Necessity as a Justification to Violations of International Economic Law

Within the scope of this article, it is clearly impossible to analyze each of these measures against the background of international trade law or international investment law.[15] Some may even have implications within

12 See Chapters 16 and 17 in R. Baldwin & S. Evenett (eds), *The Collapse of the Global Trade, Murky Protectionism and the Crisis: Recommendations for the G20* (2009).

13 Baldwin & Evenett, *supra* note 6, 4.

14 J. Werner, 'Revisiting the Necessity Concept', 10 *The Journal of World Trade and Investment* (2009), 551.

15 For a more detailed analysis of the possibly violated standards in international investment law, see A. van Aaken & J. Kurtz, 'The Global Financial Crisis: Will State Emergency Measures Trigger International Investment Dispute', 3 *Columbia FDI Perspectives* (2009) 3; see also Werner, *supra* note 14, 552.

both fields, such as in the case of a branch office established abroad in order to facilitate or coordinate the import of certain goods. Trade measures affecting these goods would automatically have an impact on the investment of the branch office, too. Furthermore, it would be difficult to prove that all of the measures violate international agreements. The measures described above are not *ipso facto* contrary to international law. Indeed, international economic law permits exceptions from the duty to observe the rules in fields such as health protection or protection of the environment,[16] and it might be difficult to show in specific cases that relying on these exceptions is unjustified.

Leaving such specific questions aside, each of the cases raises the question of whether international economic law recognizes that, in cases of economic emergency, violations of the rules may be justified. If that question is answered in the affirmative, the next issue is whether all of the various protectionist state measures taken for reason of the severe global economic crisis can be regarded as justified. This question must be addressed separately regarding the two fields of trade and investment law.

I. Necessity Within the System of WTO

The GATT[17] has a rather extensive system of exceptions from the prohibition of trade restricting measures.[18] Interestingly enough, however, it does not contain provisions regarding "economic necessity". The GATT provides for "Emergency Action on Imports of Particular Products" (Art. XIX), "General Exceptions" (Art. XX) which mostly concern measures in protection of human life, health, and environment, and "Security Exceptions" (Art. XXI). If one regarded the crisis as an "emergency" one might arguably consider Art. XXI (b) (III) which addresses also the case of an "other emergency in international relations". However, on reading this in context it becomes clear that a mere economic crisis does not fit to the key notion in this paragraph which is the "essential security interest".[19]

16 Baldwin & Evenett, *supra* note 6, 4.

17 For descriptions of the WTO system, see P. van den Bossche, *The Law and Policy of the World Trade Organisation*, 2nd ed. (2008); W. Weiß *et al.* (eds), *Welthandelsrecht*, 2nd ed. (2009).

18 See in particular van den Bossche, *supra* note 17, 614-683.

19 In this sense, see H.-J. Prieß & G. M. Berrisch, *Handbook on WTO* (2003), 157 as well as M. Hilf & S. Oeter, *WTO Law* (2005), 194-195; see for a general description also Bossche, *supra* note 17, 664-667.

Even if one considered some of the measures in the context of the justifications provided by GATS, no other result would be achieved.[20] Here, too, we have a list of comparable exceptions to those of the GATT. And in one of these, Art. XIV GATS, we find opposed to Art. XX GATT that "measures necessary […] to maintain public order" may also be justified. Even if one does not go into the difficulties of an examination of the "chapeau" of Art. XIV GATS[21], it would be extremely difficult to find reasons for the assertion that basic values of society and "public order" were in danger when the measures were taken.

Accordingly, the trade rules themselves do not constitute a basis which could justify protectionist measures. If there were a basis for justification, this could thus only be found outside the explicit rules within general international law. However, considering that the WTO system is explicit regarding the set of exception rules and is likewise concerned with determining specifically their content, recourse to rules of customary international law is not convincing. In respect of the regime of exceptions, the WTO system has to be regarded as a self-contained regime which does not allow any additional justification based on customary international law. This understanding is also consistent with the object and purpose of the agreements which were meant to provide a reliable system of trade liberalization even in – and one might even say specifically in cases of – economic crisis. Accordingly, the current economic crisis can not be brought forward in order to justify violations of the WTO agreements.

II. Necessity in International Investment Law

The legal situation of international investment law is in many respects quite different to that in the WTO system.[22]

First, contrary to the GATT and GATS the great majority of all bilateral investment treaties (BITs) does not provide for any exceptions to the protection standards. An exception regime is hardly ever found. It is only now that some countries have begun to modify their Model BITs in

[20] See in this respect Bossche, *supra* note 17, 652-653.

[21] Art. XIV provides that a measure "applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between two countries where like conditions prevail, or a disguised restriction on trade in services" shall not be subject to a justification.

[22] See for a general account of international investment law J. Griebel, *Internationales Investitionsrecht* (2008).

respect of such rules. Often Art. XX GATT and Art. XIV GATS serve as a sample which is sometimes to a greater sometimes to a lesser degree copied.[23] The second difference lies in the fact that some BITs do provide for a kind of necessity defense.[24] Still, the exceptional character of such rules must be emphasized, and modern Model BITs are quite restrictive in this respect.[25] Third, it is generally recognized that the so called "circumstances precluding wrongfulness"[26], justifications under customary international law to which "necessity" forms a part,[27] can in principle be relied upon in international investment disputes.[28] BITs do not, contrary to the WTO rules, provide for a self-contained regime in this respect.

It is interesting that the two main areas of international economic law concerning trade and investment have developed differently in this respect. It may very well be that today's international economic law concerning the trade in goods and services has already tried to learn the lessons of the deep economic depression of the years 1929-1933 and that these experiences are reflected in the WTO system. Compared to the area of international trade law, international investment law is at a rather archaic stage with respect to an explicit regime of exceptions. Not even questions of health and environment are generally recognized by way of explicit rules as exceptions from general rules.

The question as to whether a state can rely on necessity in investment disputes has been raised in cases involving Argentina. Here, the tribunals

23 See in particular Art. 10 of the *Model of Canada* (2004) and Art. 24 of the *Draft Model of Norway* (2007), available at http://ita.law.uvic.ca/investmenttreaties.htm (last visited 14 June 2010).

24 See for example Art. XI of the BIT between Argentina and the USA, available at http://www.unctad.org/sections/dite/iia/docs/bits/argentina_us.pdf (last visited 14 June 2010); see A. K. Bjorklund, 'Economic Security Defenses in International Investment Law', in Karl P. Sauvant (ed.), *Yearbook on International Investment Law & Policy 2008-2009* (2009), 479, 492.

25 Of the Model BITs of the USA, Canada, France, Germany, India and Norway none provides for such a clause, see the mentioned BITs available at http://ita.law.uvic.ca/investmenttreaties.htm (last visited 14 June 2010).

26 Terminology of the International Law Commission in its Articles on State Responsibility.

27 *Gabčíkovo-Nagymaros Project*, ICJ Reports (1997) 7, 63 para. 102 and Bjorklund, *supra* note 24, 480, with further references to investment cases.

28 See in general R. Dolzer & C. Schreuer, *Principles of International Investment Law* (2008), 168.

were concerned with governmental measures as a reaction to the Argentine Financial Crisis at the beginning of the 21st century. The central point was that the Peso was devalued, leading to considerable losses incurred by various foreign investors.[29]

If one looks at the Articles on State Responsibility of the International Law Commission,[30] Art. 25 of these articles lists the prerequisites of necessity. In principle three rather complex requirements need to be given: According to this rule, a measure must be "the only way for the state to safeguard an essential interest against a grave and imminent peril". Furthermore, it may not "seriously impair an essential interest of the state or states toward which the obligation exists" and finally, no reliance on necessity is possible if "the state has contributed itself to the situation of necessity".

In the Argentina investment law cases,[31] the majority of tribunals as well as literature have already correctly established that Argentina had contributed to the crisis.[32] However, contrary to a national economic crisis, it is rather difficult if an international financial crisis occurs to directly attribute some responsibility to a particular state. Even regarding the United States, it would be difficult to argue that they are responsible by reason of the fact that the crisis is seen to have started on United States' territory. In cases of a common failure of the whole of the international state community, it would be inadequate to blame specific states.

Doubts can furthermore be expressed that one cannot regard the states as acting in order to preserve a predominant interest to protect its citizens from a great danger which was immediately threatening it. It is a matter of fact that the arbitral tribunals involved with the Argentina cases have treated

29 For further explanations see S. Schill, 'Auf zu Kalypso? Staatsnotstand und Internationales Investitionsschutzrecht', *SchiedsVZ* (2007) 179.

30 See J. Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (2002).

31 See in particular *CMS v. Argentina*, ICSID Case No. ARB/01/8, *Enron v. Argentina*, ICSID Case No. ARB/01/3, *Sempra v. Argentina*, ICSID Case No. ARB/02/16, *LG&E v. Argentina*, ICSID Case No. ARB/02/1, *Continental Casualty Company v. Argentina*, ICSID Case No. ARB/03/9.

32 See in particular *CMS v. Argentina*, *supra* note 31, Award, para. 329; Bjorklund, *supra* note 24, 491.

the criterion of *essential interest against a grave and imminent peril* rather generously.[33]

It may thus be crucial to ask the key question whether a measure was "the only means" in order to secure the essential interest against a grave danger. In its commentary, the International Law Commission has indicated under which circumstances it is impossible to speak of the only means.[34] This would be the case, "if there are other [otherwise lawful] means available, even if they may be more costly or less convenient." On the basis of this rigid understanding, a measure applying the law in either a discriminatory or otherwise protectionist way will hardly ever be justified.[35] Especially subsidies of highly industrialized countries could also have been executed with a little more financial input and little less effectiveness and would then have been in conformity with international law. Therefore, the criterion of the "only means" is likely to be decisive in all upcoming cases concerning the measures taken during the financial crisis.

Leaving aside for a moment the question whether or not one can apply necessity as a justification, the further question at stake is whether a given case of necessity would also exclude a duty to compensate for losses.[36] Art. 27 of the ILC Articles on State Responsibility states in this respect the following: "The invocation of a circumstance precluding wrongfulness in accordance with this chapter is without prejudice to: […] (b) The question of compensation for any material loss caused by the act in question".[37] With regard to this provision, there is a tendency in investment jurisprudence to hold that there is a duty to compensate even in cases of such an emergency.[38] For example, the arbitral tribunal in the claim of *CMS v. Argentina* held that "Article 27 establishes the appropriate rule of

33 See especially *CMS v. Argentina*, *supra* note 31, Award, paras 319-322.

34 Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries (2001), available at http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (last visited 14 June 2010), 83, para. 15.

35 See on this point also Aaken & Kurtz, *supra* note 15.

36 So on this point Bjorklund, *supra* note 24, 500.

37 See for a commentary: Draft Articles on Responsibility of States for Internationally Wrongful Acts, with Commentaries (2001), available at http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf (last visited 14 June 2010), 85.

38 See with further reference Bjorklund, *supra* note 24, 501.

international law on this issue".[39] As a consequence, any invocation of a situation of emergency may justify not honoring certain obligations for a certain period of time. However, after the readjustment of the necessary state of the law, compensation for losses that had happened during this period of time should be possible. It shows that there would be a duty to compensate for damages regardless of whether or not one accepts the justification.

III. Tentative Results

Against this background, one could draw the following conclusions: Even if necessity can in principle be invoked in order to justify violations of international investment law as opposed to WTO law, its field of application, even in economic crisis situations, is rather limited. It is therefore doubtful that, regarding the current economic crisis, necessity could be invoked successfully by any specific state. Even if this were possible, there would still be the duty of compensation under the customary law principle laid down in Art. 27 of the ILC Articles on State Responsibility. Necessity is thus not the easy way out which would open new exceptions to states.

D. Perspectives

The number of different protectionist measures taken by states in response to the current economic crisis is remarkable. This rather short examination has made evident that states are prepared to breach international legal obligations if it is necessary to protect their own interests.

While it has further become clear that the effects of a necessity defense are very limited, one has to point out that there is not yet a reliable precedent concerning situations of global financial and economic crisis which would allow a more thorough examination and assessment of what governments would be allowed to do.

This may well have been one of the reasons why states are currently demonstrating a clear tendency to use protectionist measures. Apart from this, they will have stimulated each other in taking protectionist measures in violation of international law. Accordingly, one can assume that compliance

[39] *CMS v. Argentina*, Award, para. 390.

with international economic obligations is not quite on the agenda of states in economic crisis situations.

What one can already see on the horizon are the first claims with an investment law background against government measures in the course of the financial crisis.[40] The recovery of a bank in Kazakhstan through a Kazakhstani government fund which purchased the 57.1% majority of shares and lowered the percentage owned by the other shareholders has already led to a claim before an international arbitral tribunal.[41] Dutch shareholders have already filed a claim and other claims of Austrian shareholders are expected to follow. Further, it is reported that a Chinese financial services provider is planning a claim against Belgium with respect to a bank's insolvency in the course of the financial crisis.[42] Along such lines, it would not be surprising if foreign shareholders of the Lehman Brothers would come with claims based on discrimination because the United States government failed to grant support to the Lehman Brothers while at the same time rescuing other banks.

All these claims are likely to give rise to in depth considerations concerning necessity by the arbitral tribunals. This will hopefully lead to jurisprudence which will give directions as to which degree governmental measures are limited by international economic obligations. In this respect, the international economic crisis is not only a big challenge for the international economic and financial order which produced interesting examples of protectionist measures. It is an opportunity for academia and international organizations to suggest how the legal background for government action should be readjusted. In this respect, there can be no doubt that the current financial crisis also has its positive aspects.

40 Werner, *supra* note 15, 552.
41 See report in IA Reporter Vol. 2, no. 8, topic 7.
42 See report in IA Reporter Vol. 2, no. 11, topic 3.