An Analysis of the Countervailing Measures used to address the Anti-competitive Effects of Government Subsidies in the African Continental Free Trade Area

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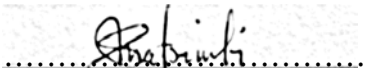
Student's signature: ……  ……

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Abstract

Government subsidies are becoming more prevalent on the African continent. Subsidies allow the government to intervene in markets to incentivise more investment into nascent and struggling industries by improving the efficiency of firms in such industries. As such, subsidies form an essential part of some African countries' industrialisation policies. However, the use of subsidies faces a challenge because of the prohibition contained in the World Trade Organisation's (WTO) Agreement on Subsidies and Countervailing Measures (SCM Agreement). The SCM Agreement prohibits the granting of subsidies that are contingent on export performance or the use of domestic over imported content. While African countries have not faced challenges in the WTO for their use of these subsidies, this may change with the operation of the African Continental Free Trade (AfCFTA) Agreement. This is because the AfCFTA Agreement localises the WTO's rules on subsidisation. This study critically examines the provisions in the AfCFTA Guidelines on the Implementation of Trade Remedies that regulate the use of export subsidies and subsidies contingent on the use of domestic content. It discusses how the absolute prohibition of these subsidies in the AfCFTA Agreement is not the most effective way to regulate their anti-competitive effects in the African continent. Specifically, this study discusses the role that competition policy might play in ensuring that export subsidies and local content subsidies are regulated in a manner that suits Africa's context. Ultimately, this study concludes and recommends that the AfCFTA must develop unique rules to regulate subsidies in a way that caters to the needs of the continent.

Keywords: government subsidies, competition policy, African Continental Free Trade Area, World Trade Organisation, Agreement on Subsidies and Countervailing Measures

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Acronyms and Abbreviations

ABR – Appellate Body Report of the WTO Dispute Settlement Body

AfCFTA Agreement – Agreement Establishing the African Continental Free trade Area

AfCFTA – African Continental Free Trade Area

Annex 1A – Annex 1A to the Agreement Establishing the World Trade Organisation

Annex 5 – Annex 5 to the AfCFTA Protocol on Trade in Goods on Non-Tariff Barriers

Annex 9 – Annex 9 to the AfCFTA Protocol on Trade in Goods on Trade Remedies

Competition Protocol – AfCFTA Protocol on Competition Policy

Dispute Settlement Protocol - AfCFTA Protocol on Rules and Procedures on the Settlement of Disputes

EPZ – Export Processing Zone

EU – European Union

FDI – Foreign Direct Investment

GATS – General Agreement on Trade in Services

GATT – General Agreement on Tariffs and Trade

Guidelines – AfCFTA Guidelines on the Implementation of Trade Remedies

LDC – Least Developed Country

Marrakesh Agreement – Agreement Establishing the World Trade Organization

The Protocol - Protocol on the Accession of the People's Republic of China

Protocol on Goods – The AfCFTA Protocol on Trade in Goods

PR – Panel Report of the WTO Dispute Settlement Body

SDT – Special and Differential Treatment

SCM Agreement – The Agreement on Subsidies and Countervailing Measures

SPS Agreement – Agreement on Sanitary and Phytosanitary Measures

TBT Agreement – Agreement on Technical Barriers to Trade

TFEU – Treaty on the Functioning of the European Union

Vienna Convention – The Vienna Convention on the Law of Treaties

WTO – World Trade Organisation

Chapter 1: Introduction and background

1.1 Introduction

When the African Union (AU) was established, it was hoped that it would be a manifestation of political and economic integration in Africa. From a trade perspective, the rationale for integration was a belief that it would enable the continent to meet the challenges of a rapidly changing world effectively.[1] Furthermore, integration was considered necessary to increase Africa's bargaining power with the rest of the world.[2] Integration was meant to enable the African continent to collectively address the effects of globalisation and create a collective voice through which it could represent individual countries' interests.

In this context, African trade was expected to catalyse economic growth and development. This has not happened yet.[3] One of the main reasons behind the stagnation is that Africa's trade with countries outside the continent is higher than intra-African trade.[4] Intra-African trade is vital in Africa because the small sizes of the continent's economies mean that trade forms an integral part of accelerating their development.[5] Therefore, the lack of intra-African trade means that most countries cannot tap into new markets and increase their competitiveness, both within the continent and globally.[6]

Additionally, intra-African trade is low compared to other regions. In 2016, and two years before the Agreement Establishing the African Continental Free Trade Area (the AfCFTA Agreement) was signed, intra-Africa imports were estimated to amount to 4.3 per cent of Africa's GDP.[7] This was in contrast with 17.9 per cent of the GDP in Asia and 21 per cent of

[1] S Okhonmina "The African Union: Pan-Africanist Aspirations and the Challenge of African Unity" (2009) 4 *Journal of Pan African Studies* 85 at 90.
[2] *Ibid.*
[3] African Union "Action Plan for Boosting Intra-African Trade" 2012 *Synthesis Paper on Boosting Intra-African Trade and Fast Tracking the Continental Free Trade Area* 1 at 2.
[4] *Ibid.*
[5] MS Kimenyi and K Kuhlmann "African Union: Challenges and Prospects for Regional Integration in Africa" 2012 *Whitehead Journal of Diplomacy and International Relations* 7 at 9.
[6] D Njinkeu & BP Fosso "Intra-African Trade and Regional Integration" https://www.researchgate.net/publication/228615205 (Accessed 22 March 2020) 1 at 7; African Union 2012 *Synthesis Paper on Boosting Intra-African Trade and Fast Tracking the Continental Free Trade Area* 2.
[7] United Nations Economic Commission for Africa *et al* "Assessing Regional Integration in Africa VII: Innovation, Competitiveness and Regional Integration" 2016 vii at 16.

the GDP in Europe during the same period.[8] Currently, countries in Southern Africa have the highest share of intra-African trade in GDP, a majority of them being members of the Southern African Development Community (SADC).[9]

South Africa and Botswana are currently two of the countries with the highest share of intra-African imports and exports.[10] Their levels of development relative to other African countries have made it easier to trade with other African countries despite the high costs of trading in Africa, in comparison to the costs of trading with countries outside the continent. This is in contrast with other countries in the continent, such as Sub-Saharan Africa, where inadequate infrastructure and institutions have contributed to higher trade costs.[11] The result is that these countries have not been able to improve their level of intra-African trade.

In 2012, at the 18th Ordinary Session of the Assembly of Heads of State and Government of the AU,[12] it was affirmed that Africa remains marginalised from the global economy due to constraints on intra-African trade.[13] As a result, a continental free trade area was considered necessary to accelerate regional integration in Africa. In 2015, African leaders held a meeting of the Assembly of the AU, which launched negotiations to establish the African Continental Free Trade Area (AfCFTA).[14] This resulted in the establishment of the AfCFTA Agreement.

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[8] *Ibid.*

[9] United Nations Economic Commission for Africa *et al* 2016 *UNECA Documents Publishing: Addis Ababa* 16. The SADC is an intergovernmental organisation whose goal is to further socio-economic, political and security cooperation as well as integration among 16 Southern African countries, including Angola, Botswana, South Africa, and Zimbabwe.

[10] Tralac "South Africa: Intra-Africa Trade and Tariff Profile" https://www.tralac.org/resources/our-resources/13142-south-africa-intra-africa-trade-and-tariff-profile.html (accessed 07 February 2020); Tralac "Botswana: Intra-Africa Trade and Tariff Profile" https://www.tralac.org/resources/our-resources/13368-botswana-intra-africa-trade-and-tariff-profile.html (accessed 07 February 2020).

[11] A Portugal-Perez & JS Wilson "Why Trade Facilitation Matters to Africa" (2009) 8 *World Trade Review* 379 At 380.

[12] KA Dwomoh *Trade Facilitation: A Necessary Tool for Attaining the Intended Objectives of the African Continental Free Trade Agreement* (LLM Thesis, University of Pretoria, 2019) 16.

[13] United Nations Economic Commission for Africa *et al* "Assessing Regional Integration in Africa V: Towards an African Continental Free Trade Area" 2012 1 at 11; United Nations Economic Commission for Africa *et al* "Assessing Regional Integration in Africa VIII: Bringing the Continental Free Trade Area About" 2017 1 at 11.

[14] African Union "Assembly Decision on the Launch of the Free Trade Area Negotiations" (2015) Assembly/AU/Dec 569-587; M Magwape "The AfCFTA and Trade Facilitation: Re-Arranging Continental Economic Integration" (2018) 45 *Legal Issues of Economic Integration* 1 at 2.

Amongst other things,[15] the AfCFTA Agreement is meant to boost intra-Africa trade and AU states' participation therein, and aid Africa's integration into the global economy.[16]

1.2 The AfCFTA Agreement

The AfCFTA Agreement is a treaty signed by all the members of the AU, except Eritrea.[17] The AfCFTA Agreement came into force on 2 April 2019 and has since been ratified by 29 member states,[18] to whom it will apply as of 1 July 2020.[19] The AfCFTA Agreement represents a recognition that member states of the AU are aware "... of the need to create an expanded and secure market for [their] goods and services ...".[20] Consequently, the AfCFTA Agreement establishes a continental free trade area.

A free trade area is a territory of states where different duties and regulations of trade are applied to those which apply to states outside of the territory.[21] Notably, the countries in a free trade area are expected to eliminate the duties and other restrictive regulations of trade that apply to substantially all the goods traded between the members of that free trade area.[22] This is meant to reduce barriers that restrict states in the free trade area from trading with each other. The result is that trade between members of the free trade area is liberalised, thus maximising the benefits that countries in the free trade area gain by being members thereof.

A free trade area is different from a customs union. A customs union is created when a group of states forms a single customs territory.[23] Specifically, countries in the territory: (i)

[15] The Agreement also aspires to attain the elimination of trade barriers. To this end, the AfCFTA Agreement contains both general and specific objectives, which are listed in Articles 3 and 4, and which are discussed later in this chapter.

[16] United Nations Economic Commission for Africa *et al* 2012 5; R Leal-Arcas *International Trade and Investment Law: Multilateral, Regional and Bilateral Governance* (2010) 77; Magwape 2018 *Legal Issues of Economic Integration* 2.

[17] The African Union is a continental organisation consisting of the 55 countries in the African continent.

[18] Tralac "AfCFTA Ratification Barometer" https://www.tralac.org/documents/resources/infographics/2605-status-of-afcfta-ratification/file.html. (Accessed 07 February 2020). Signatories of the AfCFTA Agreement agreed that it would only come into operation once 22 member states had deposited their instruments of ratification.

[19] African Union "AfCFTA Agreement secures minimum threshold of 22 ratification as Sierra Leone and the Saharawi Republic deposit instruments." https://www.au.int/en/pressreleases/20190429/afcfta-agreement-secures-minimum-threshold-22-ratification-sierra-leone-and (Accessed 20 January 2020).

[20] The Preamble to the AfCFTA Agreement; Article 2 of the AfCFTA Agreement.

[21] Article XXIV: 2 of the General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187. (the GATT).

[22] Article XXIV: 8(b) of the GATT.

[23] Article XXIV: 2 of the GATT defines a customs territory as any territory that maintains separate tariffs or other regulations of commerce for a substantial part of its trade with countries that are not a part of such territory.

eliminate all tariffs and restrictive regulations of commerce applicable to goods that originate within the territory; and (ii) apply standard tariffs and regulations of commerce in respect of their trade with states outside the territory.[24] Therefore, states that trade with members of a customs union are subject to the same duties regardless of the country through which they bring their goods.

Conversely, in a free trade area, each party maintains its separate trade agreements with countries outside of the territory.[25] This makes it possible for third countries to bring their goods through the least restrictive border of the customs territory, thereby benefitting from the concessions made by members of the free trade area.[26] Countries in free trade areas prevent third country entrants by using rules of origin,[27] to distinguish between goods that originate within the territory of the free trade area and those that do not. Rules of origin are used to determine the economic origin of goods to benefit from reduced tariffs in free trade areas.[28] Therefore, unless goods are certified as originating from a territory within a free trade area, they will not be subject to the reduced tariffs applied therein.

The AfCFTA comprises of all the member states of the AU. Firms from states in the AfCFTA will pay reduced or no tariffs for the goods that they trade therein, provided that those goods originate from a country that is in the AfCFTA. [29] The rules of origin that apply to goods traded in the AfCFTA are contained in Annex 2 to the AfCFTA Agreement.

The AfCFTA Agreement contains both general and specific objectives, the relevance of which is discussed with more depth in later chapters. According to Article 4 of the AfCFTA Agreement, the specific objectives of the AfCFTA that are relevant for this study are to:

a. "Progressively eliminate tariffs and non-tariff barriers to trade in goods;
b. Progressively liberalise trade in services;
c. Cooperate on investment, intellectual property rights and competition policies;

[24] Article XXIV: 8(a)(i) and (ii) of the GATT. H Horn, PC Mavroidis and A Sapir "Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements" 2010 *The World Economy* 1565 at 1569.
[25] P Eeckhout "Future Trade Relations Between the EU and the UK: Options After Brexit" 2018 *Policy Department for External Relations, Directorate-General for External Policies of the European Union* 1 at 12.
[26] G Fassina *et al* "Customs Unions and FTAs Debate With Respect to EU Neighbours" 2017 *European Parliamentary Research Service & Directorate-General for External Policies* 1 at 1.
[27] *Ibid.*
[28] Eeckhout 2018 *European Parliament's Committee on International Trade* 12.
[29] Article XXIV: 8(b) of the General Agreement on Tariffs and Trade.

f. Design a mechanism for the settlement of disputes concerning their rights and obligations."

The AfCFTA Agreement is being implemented in two phases. The first phase was completed in 2019. It resulted in the conclusion of the Protocol on Trade in Goods (Protocol on Goods), the Protocol on Trade in Services (Protocol on Services) and the Protocol on Rules and Procedures on the Settlement of Disputes (the Dispute Settlement Protocol). These Protocols were concluded pursuant to Articles 4(a), 4(b) and 4(f) of the AfCFTA Agreement. The second phase involves negotiations relating to Protocols on Investment, Intellectual Property and Competition Policy pursuant to Article 4(c) of the Agreement. Once these Protocols have been concluded, they will form part of the AfCFTA Agreement.

1.3 Description and context within which the research is situated

The scope of this study is limited to the regulation of subsidies in the AfCFTA. Specifically, this study examines provisions of the AfCFTA Guidelines on the Implementation of Trade Remedies (the Guidelines) that regulate the use of local content subsidies and export subsidies (collectively referred to as prohibited subsidies) in the AfCFTA. The AfCFTA has based its subsidies discipline on the subsidy rules in the World Trade Organisation's (WTO) Agreement on Subsidies and Countervailing Measures (the SCM Agreement). As a result, the AfCFTA has inherited the problems that the WTO currently faces regarding the regulation of prohibited subsidies. In this light, this study examines whether the Guidelines effectively regulates the use of prohibited government subsidies and the anti-competitive effects thereof.

1.3.1 The regulation of prohibited subsidies in the AfCFTA context

Government subsidies in the AfCFTA are regulated under Annex 9 to the Protocol on Goods (Annex 9) and the Guidelines. Guideline 28 defines a subsidy as a financial contribution by a government or any public body, which confers a benefit on the recipient thereof. According to Guideline 28.1(a), "there is a financial contribution by a government or any public body where:

i. A government or public body provides a direct transfer of funds;
ii. Government revenue that is otherwise due is foregone or not collected;

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 (ii) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by the government."

The Guidelines classify subsidies into two categories: subsidies that are treated according to their effect on the relevant market and subsidies that are prohibited, regardless of their effect. The difference between these types of subsidies is discussed in Chapter 3. This study focuses on prohibited subsidies. Guideline 29.2 provides that a subsidy is prohibited:

> "… where it is contingent in law or in fact, whether solely or as one of several other conditions, upon export performance, [and where] it is contingent, whether solely or as one of several conditions, upon the use of domestic over imported goods."

For a measure to be deemed a prohibited subsidy, the complainant must show that it is a subsidy according to Guideline 28 and that it is dependent on either a firm's export performance or its use of domestic instead of imported products. Where a measure constitutes a subsidy but is not contingent on export performance or the use of domestic over imported content, it is judged according to its effect on the relevant market. Depending on its effect, the member implementing the subsidy may be subjected to countervailing measures or required to bring its subsidy into conformity with the Guidelines.

It is accepted that subsidies may be desirable to achieve a state's policy objectives.[30] For instance, developing countries have used export subsidies to increase exports of manufactured products to reduce their dependence on raw materials.[31] However, certain subsidies may result in material anti-competitive effects to an established industry, or impede

[30] AO Sykes "The Questionable Case for Subsidies Regulation: A Comparative Perspective" (2010) 2 *Journal of Legal Analysis* 473 at 476; . JW Evans "Subsidies and Countervailing Duties in the GATT" (1977) 3 *Maryland Journal of International Trade Law* 211 at 213; JH Jackson "Perspectives on Countervailing Duties" (1990) 21 *Law and Policy in International Business* 739 at 742.

[31] J Nogués "The Experience of Latin America with Export Subsidies" (1990) 1 *Weltwirtschaftliches Archiv* 95 at 104.

the establishment of a new domestic industry.[32] Therefore, the Guidelines distinguish subsidies that serve legitimate government objectives from those that distort trade.[33]

The AfCFTA consists of developing and least developed nations that often use incentives in the form of subsidies to advance their development. These subsidies may be subjected to legal challenges or countervailing measures, even where they pursue legitimate objectives. This has been the case when developing countries have used subsides to further their development.[34] As a result, states in the AfCFTA may be unable to pursue long-term developmental objectives within their territories. For this reason, the provisions that regulate prohibited subsidies must be sufficiently clear so that member states can determine whether export and local content subsidies that serve critical policy objectives may be used.

1.4 The similarities between the regulation of subsidies in the AfCFTA and the WTO

The subsidy provisions in the Guidelines are based on provisions in the SCM Agreement.[35] This instrument regulates the use of subsidies by members of the WTO. For instance, Guideline 28 contains the definition of a subsidy, which is the same as Article 1.1 of the SCM Agreement. Similarly, Guideline 29.2 provides criteria for when subsidies are prohibited, using the same wording as Article 3.1 of the SCM Agreement.

Furthermore, the AfCFTA Protocol on Trade in Goods,[36] and the Protocol on Trade in Services,[37] contain general exceptions that allow member states to justify measures that may contravene their provisions. These general exceptions clauses are based on the general

[32] LA Grimett *Protectionism and Compliance with the GATT Article XXIV in Selected Regional Trade Arrangements* (LLM Thesis, Rhodes University, 1999) 90.
[33] Sykes 2010 *Journal of Legal Analysis* 476.
[34] Examples include subsidies related to solar technology in Appellate Body Report, *India – Certain Measures Relating to Solar Cells and Solar Modules* (16 September 2016) WT/DS456/AB/R; subsidies related to sugar in Appellate Body Report, *Thailand – Subsidies on Sugar* (7 April 2016) WT/DS507/1 (this dispute has not been brought before a Panel yet as Brazil has requested consultations with Thailand to resolve the matter without litigation); and subsidies related the development of information and communications technology (ICT) and the automotive industry in Appellate Body Report, *Brazil – Certain Measures Concerning Taxation and Charges* (13 December 2018) WT/DS472/AB/R, WT/DS497/AB/R.
[35] Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1869 U.N.T.S. 14.
[36] Article 25.
[37] Article 15.

exceptions in Article XX of the WTO's General Agreement on Tariffs and Trade,[38] (the GATT). The GATT regulates trade in goods between members of the WTO.

The Guidelines and the exceptions in the Protocols are based on the SCM Agreement and the GATT respectively because the African continent does not have subsidy laws as well as general exceptions of its own. Arguably, the problems faced by the WTO that are discussed in the next sections are likely to surface in the AfCFTA as well. Since WTO law is the basis of the AfCFTA rules on subsidies, WTO law and jurisprudence is referred to in this study to provide guidance for addressing issues related to the regulation of prohibited subsidies in the AfCFTA.

1.4.1 The regulation of subsidies in the WTO system

The SCM Agreement regulates government subsidies in the WTO. It aims to regulate government interventions that distort trade, especially when they are granted to specific firms or industries.[39] According to Article 1.1 of the SCM Agreement, a subsidy exists when there is a financial contribution by a government or any public body that confers a benefit on the recipient thereof. According to Article 1.1(a)(1) of the SCM Agreement, "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 transfer 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;"

[38] Article XX of the GATT is discussed in Chapter 4.
[39] WP Chirwa *The Regulation of Subsidies and Regional Trade Among Developing Countries in the Multilateral Trading System: The Case of Export Processing Zones in Malawi* (LLM Thesis, Rhodes University, 2017) 4.

For a benefit to exist, the recipient of the financial contribution must gain some form of advantage.[40] This means that the financial contribution must place the recipient in a more favourable position than that of its competitors in the market.[41] Therefore, if a financial contribution does not confer a benefit in the manner discussed above, a subsidy cannot be said to exist.

The SCM Agreement classifies subsidies into two categories: actionable and prohibited. As in the case of subsidies under the AfCFTA Guidelines, this study focuses on prohibited subsidies in the WTO. According to Article 3.1 of the SCM Agreement:

> "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> a) Subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;
> b) Subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods."

To establish that a prohibited subsidy exists, it must be demonstrated that a subsidy exists according to Article 1 and that the subsidy is either contingent on the use of domestic content over local content or a firm's export performance.[42]

1.4.2 The gap in the regulation of subsidies in the WTO trade system

There is uncertainty about whether a respondent state may justify measures that are prohibited in terms of Article 3.1 of the SCM Agreement. Notably, the WTO is uncertain about whether the general exceptions in Article XX of the GATT can be invoked to justify measures that are found to constitute prohibited subsidies.[43] This means that even when states use such subsidies to pursue its policy objectives, they may have to withdraw them according to the

[40] Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft* (14 April 1999) WT/DS70/R para 9.112.
[41] Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft* (2 August 1999) WT/DS70/AB/R para 158; ABR, *Canada – Certain Measures Affecting the Renewable Energy Generation Sector/ Canada – Measures Relating to the Feed-In Tariff Program* (6 May 2013) WT/DS412/AB/R/ WT/DS426/AB/R para 5.164.
[42] Rotich *Assessing Kenya's Free Trade Zones* 22.
[43] L Rubini "Ain't Wastin' Time No More: Subsidies for Renewable Energy, the SCM Agreement, Policy Space, and Law Reform" (2012) 15 *Journal of International Economic Law* 525 at 562.

provisions in the SCM Agreement. The result is that there is a lack of clarity about the ability of WTO members to use provisions of the GATT that allow them to use trade policies to address national objectives.

There are no explicit provisions in the Agreement Establishing the World Trade Organisation,[44] (the Marrakesh Agreement) nor the GATT that link Article XX to other WTO agreements.[45] Moreover, the WTO's Appellate Body has not reached a definite conclusion about the GATT's applicability to other WTO Agreements, having previously reached different conclusions on the matter.[46] The result is that there is a gap concerning how prohibited subsidies are addressed in the WTO. Ultimately, the question as to whether Article XX applies to the SCM agreement requires an assessment of the nature of the relationship between the various agreements within the framework of the WTO Agreement.[47]

1.5 Research Problem

Since the provisions of the SCM Agreement and the GATT have been adopted in the AfCFTA's Guidelines, the legal uncertainty experienced in the WTO regarding the relationship between the SCM Agreement and the GATT also exists in the AfCFTA. Similar to the WTO, it is unclear whether it is possible to invoke the exceptions in the Protocol on Goods to justify subsidies that are prohibited under the Guidelines. Particularly, the overall uncertainty is about whether member states may invoke the exceptions to justify subsidies that pursue legitimate policy objectives. The AfCFTA Agreement does not provide any guidance on this subject.[48]

It is vital to address this uncertainty because the use of subsidies may be an essential factor affecting the successful implementation of the AfCFTA Agreement. For instance, governments may use local content subsidies, to encourage firms to comply with rules of

[44] Agreement Establishing the World Trade Organisation, Apr. 15, 1994, 1867 U.N.T.S. 154.
[45] Y Ngangjoh-Hodu "Relationship of GATT Article XX Exceptions to Other WTO Agreements" (2011) 80 *Nordic Journal of International Law* 219 at 225.
[46] J Lee "SCM Agreement Revisited: Climate Change, Renewable Energy, and the SCM Agreement" (2016) 15 *World Trade Review* 613 at 621.
[47] JY Qin "The Predicament of China's 'WTO-Plus' Obligation to Eliminate Export Duties: A Commentary on the China-Raw Materials Case" (2012) 11 *Chinese Journal of International Law* 1 at 3.
[48] Qin 2012 *Chinese Journal of International Law* 3; P Low *et al* "The Interface Between Trade and Climate Change Regimes: Scoping the Issues" 2011 *World Trade Organisation Staff Working Paper ERSD-2011-1* 1 at 21.

origin.[49] For this reason, the uncertainty regarding the ability of AfCFTA members to raise justifications when measures are found to constitute prohibited subsidies is central to determining whether the AfCFTA Agreement effectively regulates prohibited subsidies.

However, the AfCFTA does not have any jurisprudence on prohibited subsidies. For this reason, this study examines literature and jurisprudence in the WTO and European Union (EU). Mainly, this study examines the gap that is faced in the WTO context as it applies in the AfCFTA context. In this light, this examination will inform the uncertainties that are likely to be experienced in the AfCFTA.

1.6 The importance of addressing the research problem.

1.6.1 The impact of domestic subsidies on international competition

Government subsidies are regulated because they have considerable distorting effects on international trade.[50] By reducing the cost of production of goods, the government incentivises firms to produce the subsidised goods instead of goods of higher real value.[51] This results in resources not being allocated efficiently or put to their most productive use.[52] Moreover, firms that receive subsidies can divert business away from more efficient competitors who do not receive such support.[53] Therefore, subsidies undermine countries' market access commitments by preventing firms that do not receive them from competing effectively.[54]

Furthermore, government subsidies represent state interference in the market because they reduce the benefits of competition as much as private barriers.[55] This is the case even though they often serve a legitimate policy objective. Export Processing Zones (EPZs) are an excellent example of this. EPZs are geographically designated areas where governments provide benefits such as reduced taxes to promote the manufacturing of goods and production

[49] United Nations Conference on Trade and Development "Economic Development in Africa Report 2019: Made in Africa – Rules of Origin for Enhanced Intra-African Trade" 2019 51 at 79.
[50] Chirwa *The Regulation of Subsidies* 17.
[51] WF Schwartz and EW Harper JR "The Regulation of Subsidies Affecting International Trade" (1972) 70 *Michigan Law Review* 831 at 840.
[52] Schwartz and Harper 1972 *Michigan Law Review* 840; Evans 1977 *Maryland Journal of International Trade Law* 213.
[53] Chirwa *The Regulation of Subsidies* 19.
[54] Sykes 2010 *Journal of Legal Analysis* 475.
[55] I Lianos and DD Sokol *The Global Limits of Competition Law* (2012) 104.

of services for export.[56] These incentives typically amount to export subsidies that distort trade. Moreover, they give the subsidised firm more market power because of the advantages they get from subsidies.[57]

Market power is the ability to influence prices, exclude competition and act, to an extent, independently of the actions of its customers, competitors and suppliers.[58] The concept of market power is concerned with the constraints that a firm faces in the market.[59] The presence of market power indicates that a firm operates in the market without much constraint.[60] When firms abuse their market power, they substantially reduce competition in the market in which they operate.[61] Subsidies prevent firms from entering into and competing effectively in markets against subsidised firms. Since subsidies are state interventions that adversely affect competition within markets, they constitute government barriers to effective competition.[62]

In several jurisdictions, competition regulation does not account for the anti-competitive effects that government barriers can create,[63] because they are often considered not to fall within the scope of competition law.[64] However, the effects of subsidies on markets can trigger the operation of competition law and policy. This is because competition law regulates restrictive practices that result in market inefficiency.[65] Subsidies may enable anti-competitive conduct in the market. Therefore, the process of competition must be protected from restraints that impair its functioning and reduce its benefits.[66] Specifically, competition

[56] NC Rotich *Assessing Kenya's Free Zones Consistency with WTO Agreements on Subsidies and Countervailing Measures and Agriculture* (LLM Thesis, University of Pretoria, 2019) 1.
[57] Rotich *Assessing Kenya's Free Trade Zones* 16.
[58] D Geradin "Competition Law an Regional Economic Integration: An Analysis of the Southern Mediterranean Countries" 2004 *World Bank Working Paper No. 35* 1 at 17; P Sutherland and K Kemp *Competition Law of South Africa* (2000) 7-26 – 7-27.
[59] Sutherland and Kemp *Competition Law of South Africa* 7-27.
[60] Sutherland and Kemp *Competition Law of South Africa* 7-26.
[61] Sutherland and Kemp *Competition Law of South Africa* 7-31.
[62] Sutherland and Kemp *Competition Law of South Africa* 7-32.
[63] B Sweeney "Globalisation of Competition Law and Policy: Some Aspects of the Interface between Trade and Competition" (2004) 5 *Melbourne Journal of International Law* 375 at 381; SW Chang "Interaction Between Trade and Competition: Why a Multilateral Approach for the United States?" (2004) 14 *Georgetown Journal of International Law* 1 at 6.
[64] Sweeney 2004 *Melbourne Journal of International Law* 381; Chang 2004 *Georgetown Journal of International Law* 6.
[65] Sutherland and Kemp *Competition Law of South Africa* 4-32. Sutherland and Kemp argue that South African competition law, for instance, seeks to address anti-competitive behaviour by the state. The rationale behind this is that competition law governs economic activity, and the state cannot escape from its application on the basis of its status if its activities are economic in nature.
[66] DJ Gerber *Global Competition: Law, Markets and Globalization* (2010) 2.

law regulates the anti-competitive tactics employed by firms to gain advantages in the market.[67]

Competition law is vital in this context for two reasons. Firstly, while subsidies are essential tools for development, they can hinder market access,[68] for firms competing with subsidised entities.[69] To this extent, it is essential to investigate the importance of using competition policy to regulate subsidies as government barriers that affect competition in markets. Furthermore, the AfCFTA Guidelines are based on the SCM Agreement, which indirectly regulate the anti-competitive effects of government subsidies, even though the WTO does not have a separate competition policy.[70] Arguably, the gap which exists in the WTO and, in turn, the AfCFTA may be a result of the fact that the relevant agreements do not regulate the anti-competitive effects of prohibited subsidies more directly.

1.7 The role of competition policy in regulating government subsidies in the AfCFTA

Subsidies often form an essential part of countries' industrial policies, which are policies that are used to create, and in some cases, expand countries' productive capacities and, therefore, increase their competitiveness in the international economy.[71] Such policies are customarily employed to increase the productive capacity of new industries or shield existing industries from market forces that threaten their existence. While they may have an impact on resolving market failures, prohibited subsidies hinder competition by giving governments the ability to pick companies that get to succeed in the market.[72]

Competition originates from different companies' interactions in the market and is vital because it provides an incentive for businesses to increase the quality of their goods while keeping prices low.[73] Competition policy refers to all the measures that a government uses to

[67] Geradin 2004 *World Bank Working Paper No. 35* 17.
[68] Market access refers to the conditions associated with the entry of firms into a particular market to trade their goods or services. See MM Dabbah *International and Comparative Competition Law* (2010) 582.
[69] *Ibid.*
[70] Dabbah *International and Comparative Competition Law* 125.
[71] KC Shadlen "Exchanging Development for Market Access? Deep Integration and Industrial Policy Under Multilateral and Regional-Bilateral Trade Agreements" (2005) 12 *Review of International Political Economy* 750 at 753.
[72] P Aghion *et al* "Industrial Policy and Competition" 2012 *NBER Working Paper 18048* 1 at 1.
[73] S Joekes & P Evans *Competition and Development: The Power of Competitive Markets* (2008) 2.

promote competitive behaviour and protect the process of competition in markets.[74] The purpose of competition law is to eliminate abuses by firms in the market place and ensure that future abuses are prevented.[75]

Having investigated the gap in the regulation of prohibited subsidies in the AfCFTA, this study then involves an investigation of whether competition law and policy may provide solutions that maximise countries' policy space while combating their anti-competitive effects. The use of prohibited subsidies has the effect of altering competitive relationships in the marketplace by raising the costs that non-subsidised firms incur, thereby acting as a barrier to entry.[76] Therefore, as measures that have the potential to enhance industrial development in the AfCFTA and hinder competition, prohibited subsidies may be subjected to more effective regulation under competition policy. Arguably competition policy can evaluate both the pro-competitive and anti-competitive effects of subsidies to determine their legal validity.[77]

Market access as a goal that is pursued by both competition policy and trade policy is discussed as a potential foundation for the regulation of local content and export subsidies in the AfCFTA.[78] In essence, the concept of market access is concerned with eliminating barriers which prevent firms from entering into new markets to compete.[79] This study involves an investigation of whether the concept of market access could form the foundation for the regulation of prohibited subsidies. Mainly, this study involves an investigation into whether a local content or export subsidy may be deemed legal or illegal depending on the extent to which it hinders market access for other firms in the AfCFTA.

Ultimately, competition policy forms a significant part of this study. While the prohibited subsidies discussed above distort international trade and contradict countries' market access commitments, it might be through the reduction of competition between firms operating on a global scale that such distortions occur. Furthermore, the distortion of trade may lie in the fact that firms that receive subsidies can acquire enough market power to prevent other firms

[74] *World Trade Organisation* "Report (1998) of the Working Group on the Interaction between Trade and Competition Policy to the General Council" 1998 *WT/WGTCP/2* para 20.
[75] Joekes & Evans *Competition and Development* 6.
[76] Lianos & Sokol *The Global Limits of Competition Law* 91.
[77] D Sokol *et al Competition Law and Development* (2013) 219.
[78] F Weiss "From World Trade Law to World Competition Law" (1999) 23 *Fordham International Law Journal* 250 at 256; Dabbah *International and Comparative Competition Law* 579.
[79] Dabbah *Comparative Competition Law* 582.

from competing in a market effectively. Therefore, this study involves an investigation of the effects of subsidies on competition and whether prohibited subsidies would be regulated more effectively in the AfCFTA if such regulation were carried out under competition law.

1.7 Goals of the research

The main aim of this study is to critically analyse the AfCFTA Guidelines to determine whether they regulates the use of prohibited government subsidies effectively. To achieve this aim, three objectives will be pursued throughout this study:

(a) An analysis of the regulation of subsidies in the AfCFTA to determine the effectiveness of the Guidelines and the Protocol on Goods.
(b) An analysis of WTO jurisprudence and literature on prohibited subsidies to determine whether it applies to the AfCFTA context.
(c) To determine the role of competition law in effectively regulating the use of prohibited subsidies in the AfCFTA.
(d) To make recommendations on the effective regulation of prohibited subsidies in the AfCFTA.

1.8 Research Methodology

This study is a theoretical study that involves a desktop analysis of primary and secondary legal sources. The method is informed by the principles of legal interpretation contained in Articles 31(1) and (2) of the Vienna Convention on the Law of Treaties (VCLT).[80]

In addition to legal sources, non-legal sources such as economic studies about the development and progress of countries in the AfCFTA have also be consulted. This is because an analysis of competition and trade policies will ultimately require an analysis of the economic context within which such policies are situated. These studies will not go beyond the theoretical nature of the study, but they will provide further background on why a particular interpretation of the law should be preferred.

[80] The Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331.

This study will involve a comparative analysis of the WTO and the AfCFTA regimes that regulate subsidies. This analysis will highlight the similarities in how the WTO and the AfCFTA regimes regulate prohibited subsidies. Due to a lack of subsidy disputes involving African countries, this study uses case law involving developing countries that have comparable conditions. This aims to highlight the vulnerability of developing countries to subsidy litigation. Furthermore, the fact that the AfCFTA Agreement is still new and that the AfCFTA Competition Protocol has not been drafted, the number of sources available in chapters discussing subsidies in the AfCFTA and the AfCFTA Competition Protocol are limited.

The analysis will highlight the different contexts within which the WTO and the AfCFTA regulate prohibited subsidies. Since some AfCFTA members are also members of the WTO, the comparative analysis aims to contribute to how the similarities and differences between the AfCFTA and the WTO may impact their ability to use subsidies. Moreover, the analysis aims to show that the principles used to justify the application of the GATT to the SCM Agreement in the WTO are equally applicable to the question of whether states can justify the use of prohibited subsidies in the AfCFTA.

Furthermore, this study involves a comparative analysis of underlying principles of the laws regulating the use of subsidies and some principles underlying competition law. Particularly, this study involves an analysis of the EU's State Aid rules to illustrate how subsidy disciplines that are regulated through competition frameworks function. This analysis intends to show that the regulation of subsidies is governed by principles that reflect the protection of competition in international markets. Ultimately, this analysis will be used to determine whether the use of government subsidies would be more effectively regulated through competition policy.

As all documentary data used in this study are publicly available, no ethical considerations arise.

1.9 Overview of chapters

This study begins in chapter two. This chapter involves an investigation of why government subsidies are an essential part of the development of states in the AfCFTA. In this light, the various reasons for and how subsidies are used are explained in this chapter. Furthermore, it involves an analysis of how government subsidies impact firms' ability to compete

effectively in the AfCFTA market. Mainly, the chapter will discuss the way subsidies result in the abuse of subsidised firms' market power. Finally, an analysis is carried out to explain why it is essential to regulate this impact. Mainly, this chapter analyses subsidy disputes involving developing countries in the WTO to highlight the importance of balancing between the anti-competitive effects of subsidies and their policy objectives. The lack of subsidy disputes involving African countries makes it necessary for this chapter to analyse disputes that involve other developing WTO members outside the African continent.

Chapter three discusses the regulation of subsidies in the AfCFTA. The chapter specifically analyses the Protocol on Goods and the Guidelines. The purpose is to highlight the gap which exists in the regulation of prohibited subsidies due to the provisions of the Protocol on Goods and the Guidelines being transplanted from the SCM Agreement and the GATT, respectively. Particularly, it explains that there is a lack of clarity as to whether the exceptions in the Protocol on Goods apply to subsidies that are prohibited by the Guidelines. Finally, it is explained how uncertainty about this relationship is likely to affect the regulation of subsidies in the AfCFTA

Chapter four is an analysis of the WTO's subsidies discipline. It expands on prohibited subsidies and how they are regulated in the WTO. More importantly, the chapter unpacks the debate regarding the applicability of the GATT to the SCM Agreement and analyses the WTO's current jurisprudence on this issue. Furthermore, principles of treaty interpretation contained in the VCLT are applied to interpret the relationship between the GATT and the SCM Agreement. Ultimately, the chapter analyses whether the principles explored therein may be applied to the AfCFTA Agreement.

Chapter five discusses the role of competition policy and law in regulating prohibited subsidies. It involves a brief discussion of why these subsidies must be considered as a competition law issue rather than strictly a trade issue. Moreover, the chapter explores the links between trade policy and competition policy, particularly concerning what this relationship might mean for the future regulation of prohibited subsidies. The potential benefits of regulating prohibited subsidies under competition law are discussed. The study includes an analysis of the EU's State Aid rules, which aims to illustrate that the regulation of subsidies through a competition framework is not entirely unprecedented.

Chapter six is a conclusion of the study. It briefly explores the feasibility of competition policy as a way to regulate prohibited subsidies in the AfCFTA. Mainly, it discusses the upcoming AfCFTA Protocol on Competition Policy as an opportunity to use competition policy to fill the gap in the regulation of subsidies. Ultimately, the chapter summarises the findings of the study and gives recommendations on further research in this field.

1.10 Conclusion

This chapter has introduced the study and its importance in the future regulation of prohibited subsidies in the AfCFTA. Specifically, the chapter highlights three critical things. First, the use of subsidies has important implications for competition in markets, and any regulation thereof must adequately capture this fact. Second, copying the current subsidy laws from the SCM Agreement as they are is likely to create gaps that may prevent AfCFTA members from using subsidies even when they have legitimate objectives to pursue. Finally, there is a need to investigate the role that competition policy may play in filling the gap which exists in the regulation of prohibited subsidies in the AfCFTA.

Chapter 2: The purpose and impact of subsidies in the AfCFTA

2.1 Introduction

This chapter discusses the rationale for the use of subsidies in developing countries and particularly in the African continent, as a part of their industrial policy. This chapter does not purport to discuss all the reasons that subsidies are granted, but just the most significant ones in the context of African countries. The first part of the chapter will discuss how market failures in developing countries create distortions in markets,[1] thereby creating the need for selective intervention by the government to correct such failures. It is argued that in some situations, the most optimal mechanism to correct market failures may not be available to a government; hence they use subsidies instead.

With regard to the use of subsidies to correct market failures, this study explores examples of situations in which countries have used subsidies that have been subjected to dispute proceedings and subsequently ruled to be prohibited. Such examples aim to highlight how countries that use local content and export subsidies are vulnerable to challenges to their subsidy programmes even if such programmes pursue legitimate objectives. However, it is essential to note that this point is illustrated using disputes that have been brought before the WTO involving developing countries outside the African continent. This is because although African countries use subsidies, there have not been any African countries involved in subsidy disputes in the WTO.

The second part of this chapter discusses the possibility that even when the use of a subsidy to correct market failures is justified in the circumstances, subsidies can restrict competition in markets. The effects of subsidies on competition are discussed in two contexts. First, government subsidisation is discussed as a public restraint on competition that acts as a barrier to entry for firms aiming to compete in specific markets. In such a context, the use of the subsidy may also lead to market failure by creating barriers to entry. Second, subsidies

[1] See *World Trade Organisation* "World Trade Report 2006: Exploring the Links Between Subsidies, Trade and the WTO" 2006 *WTO Publications.*

are discussed as a measure that enables firms to engage in anti-competitive market conduct. Finally, the importance of this chapter in this study is discussed.

2.2 The different types of subsidies

Subsidies can be distinguished according to whom the recipient of such a subsidy is. While most subsidies have the effect of reducing the costs that consumers have to pay, it is the recipient of the subsidy, which determines whether the Guidelines apply to the subsidy.[2] To this extent, the factor which decides whether a subsidy should be scrutinised under applicable law is whether the subsidy is received by the consumer of a product or the producer thereof.[3]

2.2.1 Consumer subsidies

Governments often engage in social protection, which refers to all the policies, systems, and programs they implement to combat poverty or assist people in coping with societal risks and shocks such as the sudden increase in food or fuel prices.[4] Such social protection may involve the subsidisation of goods and services by a government.[5] Such a subsidy is known as a consumer subsidy. The subsidy is intended to lower the costs that consumers are required to pay for certain goods and services.[6] A consumer subsidy exists where the prices paid by consumers for goods, which include both firms that produce intermediate goods and households, are below the prices it costs to supply the goods.[7]

Essentially, this ensures that the beneficiary of the subsidy, which is the consumer, only pays the cost price of the product. On the other hand, the government pays the difference between the cost price and the marked up price that would have been charged to the consumer in the absence of the subsidy.[8] Some low-income countries use consumer subsidies to subsidise food and to make it more affordable.[9] An example of a consumer subsidy is when governments subsidise the price of fuel in a country so that consumers pay lower prices for

[2] D Coppens *WTO Disciplines on Subsidies and Countervailing Measures: Balancing Policy Space and Legal Constraints* (2014) 5.
[3] *Ibid.*
[4] S Sharma *et al* "How to Target Electricity and LPG Subsidies in India: Step 1. Identifying Policy Options" 2019 *International Institute for Sustainable Development (IISD)* 2 at 2.
[5] *Ibid.*
[6] Coppens *Disciplines on Subsidies* 5.
[7] B Clements *et al* "Energy Subsidies: How Large are They and How Can They Be Reformed?" (2014) 3 *Economics of Energy & Environmental Policy* 1 at 2.
[8] Clements *et al* 2014 *Economics of Energy & Environmental Policy* 2; Sharma *et al* 2019 *IISD* 2.
[9] RT Jensen and NH Miller "Do Consumer Subsidies Really Improve Nutrition?" (2011) 93 *The Review of Economics and Statistics* 1205 at 1205.

fuel.[10] Since these subsidies are directed at a non-specific group of people, and because there are no specific conditions attached to receiving them, they do not attract the scrutiny of the law.[11]

2.2.2 Producer subsidies

When a producer directly receives a subsidy, it is referred to as a 'producer subsidy'. A producer subsidy exists where retail prices are set above the cost of supplying the goods. They are usually intended to cover the inefficient operations of domestic producers.[12] The requirements for receipt determine the kind of producer subsidy it is. Specifically, where a producer subsidy is concerned, the conditions for receiving such a subsidy play a role in determining whether it is lawful.[13] Furthermore, AfCFTA Guidelines that regulate producer subsidies also distinguish between 'export subsidies' and 'domestic subsidies'.

An export subsidy will only be paid to a producer for the products that it exports to foreign markets.[14] Therefore, the receipt of such a subsidy is contingent on whether a producer exports its product and, in some cases, how much it exports. As will be shown below, these types of subsidies are prohibited by the Guidelines.[15] All other kinds of subsidies that are not export subsidies are known as domestic subsidies and are categorised according to the activity that they aim to stimulate.

Domestic subsidies may be grouped into three categories. The first is input subsidies, which are subsidies on one or a variety of the inputs required for the production of a good.[16] Input subsidies are often used to subsidise investment, which helps stimulate economic activity when economic output falls below estimated or potential output.[17] Such subsidisation occurs

[10] C Verkuijl *et al* "Why Have Fossil Fuel Subsidies Evaded Litigation?" 2017 *Climate Strategies* 28 at 30
[11] Verkuijl *et al* 2017 *Climate Strategies* 31.
[12] Clements *et al* 2014 *Economics of Energy & Environmental Policy* 2.
[13] Coppens *Disciplines on Subsidies* 6.
[14] *Ibid.*
[15] Guideline 29.2, which is discuss in more depth below, prohibits subsidies which are contingent on the use of domestic over imported goods as well as those that are contingent on a company's export performance.
[16] R Parish and K McLaren "Relative Cost-Effectiveness of Input and Output Subsidies" (1982) 26 *The Australian Journal of Agricultural Economics* 1 at 2 See CP Bown & JA Hillman "WTO'ing a Resolution to the China Subsidy Problem" (2019) 22 *Journal of International Economic Law* 557 at 563-566.
[17] JE Aldy *et al* "Investment Versus Output Subsidies: Implication of Alternative Incentives for Wind Energy" 2018 *NBER Working Paper No. 24378* 2 at 2.

through tax cuts which incentivise firms to increase their investment.[18] For instance, a government may offer tax cuts to incentivise firms to invest in R&D within its territory.[19]

Secondly, output subsidies' are subsidies meant to cover the eventual output produced by a firm.[20] They are typically provided to a producer on all their production, regardless of whether it is meant for domestic consumption or exportation.[21] For instance, such subsidisation may take place through government procurement when the government undertakes to purchase goods from a firm at above-market-value prices or through tax breaks.[22] Finally, local content subsidies' are granted to producers on the condition that they use domestic over imported products to manufacture their final goods.[23] The Guidelines also prohibit local content subsidies. This study only concerns itself with local content and export subsidies, which are prohibited under the AfCFTA Guidelines, and the impact of their prohibition.

2.3 The rationale for government subsidisation

2.3.1 Subsidisation in a perfect market

In a perfectly competitive market,[24] firms can compete effectively, and the relationship between supply and demand results in an efficient allocation of resources.[25] In such a market, firms will produce goods at the lowest possible price, which equals the marginal cost of production,[26] and the socially optimal price of a product.[27] Therefore, in a perfect market,

[18] AJ Auerbach *et al* "Activist Fiscal Policy" (2010) 24 *Journal of Economic Perspectives* 141 at 152.
[19] An instance of such subsidisation is given below when subsidisation during market failures is discussed.
[20] Aldy *et al NBER Working Paper No. 24378* 2.
[21] Coppens *Disciplines on Subsidies* 6.
[22] Aldy *et al NBER Working Paper No. 24378* 2.
[23] *Ibid.*
[24] A perfectly competitive market is one where firms can enter and exist without any costs, there are constant returns to scale, firms and consumers possess full information, and individual producers or consumers are unable to affect prices. See *World Trade Organisation* 2006 *WTO Publications* 55.
[25] Coppens *Disciplines on Subsidies* 6. According to W Kenton "Allocational Efficiency" https://www.investopedia.com/terms/a/allocationalefficiency.asp (accessed 15 May 2020), an efficient allocation of resources occurs when firms are able to use all the information that is readily available in the market to make decisions about how to use their capital to produce the best possible outcomes.
[26] Marginal cost of production is a concept used to determine a firm's optimum level of production. It refers to the additional cost of increasing a firm's activity. Finding the marginal cost of production helps determine the level of production at which the overall cost of producing the product will decrease. See A Tuovila "Marginal Cost of Production" https://www.investopedia.com/terms/m/marginalcostofproduction.asp (Accessed 15 May 2020); N Hashimzade *et al A Dictionary of Economics* 5ed (2017) 100.
[27] According to Hashimzade *et al A Dictionary of Economics* socially optimal price refers to the price at which a firm's profit will be maximum, while also simultaneously maximising social welfare. Coppens *Disciplines on Subsidies* 6.

welfare,[28] is maximised, and government intervention will only distort the market and diminish that welfare by inefficiently allocating resources.[29] In such a case, a subsidy reduces the price paid by consumers and creates an overall welfare loss because it results in an inefficient allocation of resources in the market.[30]

The welfare effects of subsidies in perfect markets can be explained in two ways. Firstly, domestic and export subsidies often have the effect of increasing domestic output and exportation of a product.[31] However, they differ in how they affect the local price of that product. In the case of a domestic subsidy, the domestic price is either unaffected or lowered, which may decrease imports of similar goods.[32] In the case of export subsidies, local prices are affected because when a domestic firm is incentivised to produce to export its products, it is likely to decrease its supply to the domestic market.[33] The result is that the local price increases because of the limited amount of goods available in the local market.

Secondly, when a subsidy is provided by a country that is unable to affect the world price of a product (i.e., a developing country), a welfare loss arises for this country and not for developed countries. The reason is that increasing producers' welfare does not recoup the resources a government spends.[34] Consequently, there is an inefficient allocation of resources because the government is intervening in a market that is already perfectly competitive.[35]

Therefore, the intervention leads to a distortion in the market. Moreover, it forces unsubsidised firms in developing country markets to lower their prices from standard market prices to compete effectively with subsidised firms. The intervention ultimately creates a gap between the standard market price and the price paid to domestic producers, and producers suffer because they lose profits.[36]

However, the situation is different when a subsidy is offered by a country that can affect the world price of a product (i.e., a developed country). A subsidy provided by such a country

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[28] According to Coppens *Disciplines on Subsidies* 7, welfare is the sum of the difference between the price consumers have to pay and are willing to pay (i.e., the consumer surplus), the difference between the price at which producers sell and are willing to sell (i.e., the producer surplus) and government revenue.
[29] Coppens *Disciplines on Subsidies* 6; *World Trade Organisation* 2006 *WTO Publications* 55.
[30] *World Trade Organisation* 2006 *WTO Publications* 56.
[31] *World Trade Organisation* 2006 *WTO Publications* 57.
[32] *Ibid.*
[33] *Ibid.*
[34] Coppens *Disciplines on Subsidies* 7.
[35] *Ibid.*
[36] Coppens *Disciplines on Subsidies* 7; *World Trade Organisation* 2006 *WTO Publications* 56.

lowers the world price and can, therefore, affect the welfare of developing countries.[37] Globally, consumers benefit from the subsidy because the price of a product decreases. However, countries that export the same or similar products will have to compete with the subsidised firm, the result being that they end up reducing the price they charge.[38] The result is that firms in developing countries lose profits because they have to compete with subsidised firms. The WTO dispute on the United States (US) government's subsidies on upland cotton is an example of this.[39]

The US implemented programs geared towards producers of upland cotton. These measures include *inter alia*, counter-cyclical payments,[40] market loss assistance payments,[41] export credit guarantee programmes,[42] and crop insurance payments.[43] In essence, the programs in issue resulted in payments to producers of upland cotton when prices fell below a target level, effectively ensuring that the producers did not lose any profits.[44] In 2002, Brazil requested consultations with the US regarding various US government measures, which Brazil considered to constitute subsidies in violation of the SCM Agreement.[45]

The WTO Panel held that these measures were subsidies, which resulted in serious prejudice in terms of Art. 5(c) of the SCM Agreement. This is because they led to significant price suppression, price depression, or lost sales in the same market.[46] Price suppression refers to increasing the supply of a product in the market to lower its price.[47] The effect of the subsidies in question was to insulate producers from low prices, allowing them to produce more cotton than they otherwise would. Thus, they decreased the cost further by increasing the supply of cotton.[48] Ultimately, a subsidy by a 'large' country in a perfectly competitive

[37] Coppens *Disciplines on Subsidies* 7; *World Trade Organisation* 2006 *WTO Publications* 58.
[38] Coppens *Disciplines on Subsidies* 7; *World Trade Organisation* 2006 *WTO Publications* 58.
[39] See Appellate Body Report, *United States – Subsidies on Upland Cotton* (3 March 2005) WT/DS267/AB/R.
[40] This is an income support mechanism meant to cover the difference between the market price of a product and the government-established target price. See R Bhala *International Trade Law: Interdisciplinary Theory and Practice* 3ed (2008) 1136-1137.
[41] *Ibid.* these are measures designed to help producers of upland cotton make up for losses that are caused by low commodity prices.
[42] This is a type of insurance that protects an exporting firm against non-payment by an importer.
[43] Panel Report, *United States – Subsidies on Upland Cotton* (8 September 2004) WT/DS267/R para 2.1.
[44] GM Grossman and AO Sykes "Optimal Retaliation in the WTO – A Commentary on the Upland Cotton Arbitration" (2011) 10 *World Trade Review* 133 at 141.
[45] PR, *United States – Subsidies on Upland Cotton* para 1.1.
[46] PR, *United States – Subsidies on Upland Cotton* para 7.1416.
[47] PR, *United States – Subsidies on Upland Cotton* para 7.1309.
[48] PR, *United States – Subsidies on Upland Cotton* para 7.1309; RH Steinberg "United States: Subsidies on Upland Cotton. WTO Doc WT/DS267/AB/R" (2005) 99 *American Journal of International Law* 852 at 857.

market has the effect of decreasing world prices, often to the detriment of 'developing nations.[49]

The assumption of perfectly competitive markets serves as a background into the impact of government interventions such as subsidies in markets. This analysis aims to illustrate situations in which the government's intervention in the form of subsidies is often required to address problems that distort the market. Not all economies have perfectly competitive markets, and the government often needs to intervene to reduce or even prevent distortions that decrease overall welfare for both consumers and producers. To this extent, it is necessary to understand how market failures can influence a government's decision to grant subsidies to firms.

2.3.2 Subsidisation during market failures

A market failure exists where there is a difference between a product's price and the socially optimal price.[50] A socially optimal price exists where the price of the good is equal to the marginal cost of the good.[51] The problem in such a case is that the price of the product increases a firm's profits, but does not maximise welfare.[52] Market failures can take place if there is imperfect competition, where one firm or a small group of firms can control the price and output of a particular product in that market.[53] It can also take place in the presence of externalities. Externalities are benefits or costs that result from consumer or producer behaviour which are not reflected in the market and are, thus, external to the market.[54] Although there are multiple examples of market failure, only two are considered in this study.

The first example is economies of scale. Economies of scale refer to the decrease in the cost of production when firms learn how to make production more efficient.[55] It is achieved by increasing production and lowering costs.[56] An example of economies of scale is when there is a high fixed cost of entry into an industry. The high costs of entry mean that firms are

[49] Coppens *Disciplines on Subsidies* 7.
[50] *World Trade Organisation* 2006 *WTO Publications* 58.
[51] Independent Pricing and Regulatory Tribunal of New South Wales "Socially Optimal Consumption and Prices: Information Paper 5" 2015 *Transport – Information Paper* 1 at 4. See n26 above on marginal cost.
[52] Coppens *Disciplines on Subsidies* 8.
[53] *World Trade Organisation* 2006 *WTO Publications* 58.
[54] Coppens *Disciplines on Subsidies* 8.
[55] W Kenton "Economies of Scale" https://www.investopedia.com/terms/e/economiesofscale.asp (Accessed 14 May 2020).
[56] *Ibid.*

likely to charge higher prices to recover the initial investment they have made.[57] A high price is expected to reduce the demand in the market, making it unlikely that a producer will recover its initial investment. As a result, investment and production are unlikely to take place without government intervention as there would be no incentive for the firm to enter into production.[58] The aircraft manufacturing industry is an excellent example of such an industry.[59]

There may be cases in which welfare that is not reflected in the market price outweighs the losses that producers would incur without a subsidy. In such cases, a government may choose to subsidise the initial investment to provide an incentive for firms to enter the industry.[60] This may be the case where, although the cost of entry into an industry is high, the cost is exceeded by the welfare benefits that will accrue in the future. This is because a government may have an interest in ensuring that consumer well-being is reflected in the prices consumers pay.[61] There are at least two reasons that a government could offer subsidies in the presence of economies of scale.

Firstly, there may be benefits associated with learning-by-doing that are internal to a firm. This means that production costs incurred by a firm fall as its output accumulates over time.[62] This is because the firm learns how to produce more efficiently, leading to average costs decreasing over time.[63] Whether a government subsidises firms ultimately depends on whether the long term benefits outweigh the cost of subsidisation.[64] Secondly, there may be instances where a government subsidises a domestic firm or industry to improve its level of competitiveness in relation to a foreign producer.[65] This may be the case where, for instance, a government wishes to correct a market characterised by imperfect competition.

The second example is that of externalities. Externalities may be positive or negative. A positive externality exists where the benefits of producing and consuming a product are not fully acknowledged. Consequently, the quantity of the product produced is less than the

[57] *World Trade Organisation* 2006 *WTO Publications* 59.
[58] *Ibid.*
[59] The barriers to entry in the aircraft industry are discussed in more depth in Chapter 3.
[60] *World Trade Organisation* 2006 *WTO Publications* 59.
[61] *Ibid.*
[62] *World Trade Organisation* 2006 *WTO Publications* 60.
[63] *Ibid.*
[64] *Ibid.*
[65] *Ibid.*

socially optimal amount.[66] A negative externality means that the amount of goods produced is more than the socially optimal amount.[67] In both scenarios, the externality creates a gap between a product's market price and the socially optimal price. A positive externality results in higher prices because the supply of a product is limited. A negative externality results in lower prices because there is an oversupply of the product in the market.[68]

In the presence of externalities, welfare-maximising outcomes do not result from market forces correcting the distortions in the market. Instead, they require intervention by a government.[69] An example of subsidisation in the presence of externalities is cases involving R&D activities. When a firm invests in R&D, the investment results in knowledge that is not only good for its own operations, but knowledge that can also be used by that firm's competitors. The problem is that the costs of the R&D are incurred privately by the firm carrying it out and not by the industry in its entirety. Therefore, in such situations, firms in the market may be disincentivised from generating the socially optimal amount of R&D.[70]

It may be in the government's interest to generate R&D, which will spread across the rest of the industry to stimulate growth and productivity.[71] Therefore, a government may choose to subsidise firms that can carry out R&D in the market. An example of this is Brazil's taxation and charges measures, which were the subject of a dispute brought in the WTO's Dispute Settlement Body by Japan and the European Union.[72] Brazil implemented measures through which it provided exemptions, reductions, or suspensions of the federal taxes and contributions that firms had to pay. The most important of these measures targeted the information and communications technology (ICT) sector and the automotive sector.[73]

The measures related to the ICT sector exempted firms engaged in the industry from certain taxes payable to Brazil's federal government.[74] These included, *inter alia*, the informatics programme, which provided for exemptions and reductions of the tax on industrialised

[66] *World Trade Organisation* 2006 *WTO Publications* 61.
[67] *Ibid.*
[68] *Ibid.*
[69] Coppens *Disciplines on Subsidies* 8.
[70] *World Trade Organisation* 2006 *WTO Publications* 61.
[71] *Ibid.*
[72] See Appellate Body Report, *Brazil – Certain Measures Concerning Taxation and Charges* (13 December 2018) WT/DS472/AB/R, WT/DS497/AB/R.
[73] ABR, *Brazil – Taxation and Charges* para 1.6.
[74] The full range of measure can be found in ABR, *Brazil – Taxation and Charges* paras 1.7-1.12.

products payable on the sale of information technology goods.[75] The measure related to the automotive industry provided for a reduction of the tax payable on certain motor vehicles.[76] One of the main conditions for firms' eligibility to receive the exemption or reduction of their tax burdens was that they had to invest in R&D in Brazil. These conditions were inserted as a way to ensure the development of both the ICT and automotive industries in Brazil.[77]

In the presence of market failures, market forces are unable to properly correct distortions that result in diminished welfare due to the absence of perfect competition, usually caused by the ability of a few firms to control the price and level of production in the market.[78] The result is that firms are often disincentivised from entering into or investing further in specific industries. This, therefore, requires the government to intervene to correct market failures and encourage firms to invest in sectors that can maximise society's welfare in the future.[79] While market failure explains the rationale for government interventions in the market, it does not explain the objectives that governments often attempt to achieve through the interventions.

2.3.3 The objectives that governments pursue through subsidisation

The argument for the use of subsidies as part of countries' industrial policy follows from the premise that market forces in developing countries have a large number of distortions and imperfections.[80] In such a case, the distortions in the market can be improved by adequately managed and targeted government intervention.[81] There are two reasons for this. Firstly, other kinds of interventions, such as tax and fiscal incentives, are less specific to long-term developmental goals. Therefore, while subsidies are not always the optimal policy intervention required to address market distortions, they may improve welfare and efficiency in the market when carefully designed and targeted towards industries that will reap the most benefits.[82]

[75] ABR, *Brazil – Taxation and Charges* para 1.7.
[76] ABR, *Brazil – Taxation and Charges* para 1.11.
[77] Evidence of this is in requirements that the Brazilian government established for companies to be eligible for tax cuts. See, for instance Panel Report, *Brazil – Certain Measures Concerning Taxation and Charges* (30 August 2017) WT/DS472/R/ WT/DS497/R paras 2.49-2.51; 2.76-2.80; and 2.87-2.89.
[78] Coppens *Disciplines on Subsidies* 8.
[79] *Ibid.*
[80] RE Hudec *Developing Countries in the GATT Legal System* (2011) 129.
[81] *Ibid.*
[82] *World Trade Organisation* 2006 *WTO Publications* 68.

Secondly, the distortions in developing-country markets are such that market forces will not be able to direct investment and resources to their most optimal uses.[83] Therefore, government intervention is required to redirect investments to more efficient and welfare-maximising uses, provided that the benefits of such intervention exceed the costs thereof.[84] In this context, government intervention in the form of subsidies not only exists to correct market failures. They also serve as a tool to advance their industrial development in the long term. Ultimately, the government plays a significant role in providing a framework for regulating economic relationships in the market, and subsidies may be an essential tool in making that framework effective.[85] An example of the importance of the government's intervention in the market is the infant industry argument.

2.3.3.1 The infant industry argument

A primary case for government intervention is the 'infant industry' argument, which is an argument for trade protection. The argument is that in the early stages of industrialisation, countries may have higher production costs in certain, nascent, industries than the costs of production in a similar industry that is in a more industrialised nation.[86] In the former case, a potentially efficient industry exists. Still, private actors will not make investments into it either because the capital market is itself imperfect or because other distortions exist, which will disrupt that industry.[87] Therefore, if such an industry were exposed to competition at this early stage, it would fail to survive because market forces are unlikely to direct investment efficiently, which means that they will be unable to compete effectively with their counterparts.[88]

Economies of scale, particularly learning-by-doing, which has been discussed above, lie at the basis of the argument. It is argued that temporary protection allows an infant industry to gain the experience, knowledge, and skills necessary to bring the costs down to compete with similar rival sectors.[89] In this case, the government's role is to (a) accurately identify industries in which intervention is needed for protection and (b) intervene in a manner that

[83] Hudec *Developing Countries in the GATT* 129.
[84] *Ibid.*
[85] PG Sampath "Industrial Development for Africa: Trade, Technology and the Role of the State" (2014) 6 *African Journal of Science, Technology, Innovation and Development* 439 at 442.
[86] A Panagariya "A Re-Examination of the Infant Industry Argument for Protection" (2011) 5 *Journal of Applied Economic Research* 7 at 8.
[87] Hudec *Developing Countries in the GATT* 129.
[88] *Ibid.*
[89] Panagariya 2011 *Journal of Applied Economic Research* 8.

ensures that the industry in question is made viable in the future. Ultimately, the goal of the intervention is to give firms in infant industries the space to become more competitive in their respective markets. An example of such protection is Japan.

In the period between 1950 and 1970, Japan used industrial policy to contribute significantly to its development by intervening at particular moments to either encourage or restrict competition in some industries.[90] The Japanese Ministry of International Trade and Industry (MITI), coordinated collusion and sometimes even encouraged the formation of cartels in certain industries, which it considered key to its long-term development.[91] By doing this, the government shielded firms in nascent industries from competition depending on their value at the time and their contribution to the economy.[92]

However, this was not total protection from competition. The government determined whether to promote or restrict competition based on the industry and its life-cycle. Therefore, the government would only protect a firm from competition during its developmental phase but would allow competition to flourish when such firms became technologically mature.[93] One of the mechanisms that the government used was to guide firms to invest in a way that expanded their productive capacity in proportion to their market share.[94] This helped firms develop their productive capabilities and, in turn, made them more efficient and competitive in the market.

The infant industry argument has been criticised from a theoretical and practical standpoint. In this regard, two critical counter-arguments have been raised. Firstly, it is argued that learning-by-doing is an insufficient basis for the protection of an infant industry. [95] This is because if a firm can lower its production costs and make profits in the future, then it can invest in an industry without any government intervention.[96] A firm's ability to offset its loss is enough incentive for the firm to invest. Making losses in the early years and offsetting them with future gains is not exclusive to infant industries.[97] Moreover, if the capital market

[90] DI Waked "Antitrust Goals in Developing Countries: Policy Alternative and Normative Choices" (2015) 38 *Seattle University Law Review* 945 at 973.
[91] *Ibid.*
[92] *Ibid.*
[93] AH Amsden & A Singh "The Optimal Degree of Competition and Dynamic Efficiency in Japan and Korea" (1994) 38 *European Economic Review* 941 at 945.
[94] *Ibid.*
[95] J Meade Trade and Welfare (1955) 255; Panagariya 2011 *Journal of Applied Economic Research* 11.
[96] Panagariya 2011 *Journal of Applied Economic Research* 11.
[97] *Ibid.*

of a country is functioning efficiently, firms can finance initial losses and repay any loans they get out of their future profits.[98]

Secondly, it is argued that once the source of an externality is specified, protection by a government is unlikely to incentivise firms to bear the costs of learning that are needed to achieve the socially optimal price or gain the knowledge possessed by competitors.[99] This is because the protection only makes it possible for a firm to enter an industry, but it does not offer incentives for the firm to invest in innovation.[100] Moreover, protection does not protect incumbent firms from later entrants that can exploit their innovation without having to bear the costs. Later entrants drive down the price of the final product or offer to pay more for factors of production to drive their prices up, effectively driving the incumbent firm out of the market.[101]

2.3.3.2 The infant industry argument in the AfCFTA

Despite these criticisms, the infant industry argument can still be applied in the context of African countries, which consist of market distortions. Such distortions result from externalities and levels of underdevelopment that often prevent African markets from functioning efficiently. Furthermore, Article 23 of the Protocol on Goods allows AfCFTA members to implement measures to protect infant industries.[102] This provision recognises that relatively low levels of development demand that the government assume a more significant role than usual in the market to build its capabilities.[103] For this reason, there are some considerations which give some weight to the argument for protecting infant industries in African countries.

Firstly, the accumulation of technological know-how and learning capabilities is an integral part of Africa's industrial development. It is essential to equip societies with the technical skills which are crucial in bringing about an environment that is conducive to ensuring efficient and welfare-maximising markets.[104] Learning-by-doing in Africa needs to be preceded by the acquisition of technology, as well as efforts at learning how to use it and

[98] *Ibid.*
[99] RE Baldwin "The Case Against Infant-Industry Tariff Protection" (1969) 77 *Journal of Political Economy* 295 at 299.
[100] Panagariya 2011 *Journal of Applied Economic Research* 13.
[101] *Ibid.*
[102] Article 23 of the AfCFTA Protocol on Trade in Goods.
[103] Sampath 2014 *African Journal of Science, Technology, Innovation and Development* 442.
[104] Sampath 2014 *African Journal of Science, Technology, Innovation and Development* 443.

adapt it to local conditions in the market.[105] In this instance, protection insulates the industry from competition while firms build their technological capacity in preparation to enter the market.

Secondly, it is essential to recognise that the market represents a channel through which the state can facilitate growth.[106] The efficiency and openness of the market as a channel of this nature depends on the presence of mature local companies and sectors as well as the presence of infrastructure, institutional capacity, human capital, and investment.[107] The ability of the government to identify and intervene in the right sectors is crucial in ensuring that African markets are useful as a medium to advance development.

Finally, it is essential to note that the African continent now finds itself in a world characterised by multilateralism.[108] Specifically, global trading patterns in such a world are likely to affect activities in individual African markets. For this reason, firms rely on trade opportunities to get returns on their investments and inputs into innovation, and they use them to attract global FDI that can help them grow.[109] Not only is government intervention necessary for ensuring that firms are incentivised to enter into global markets to compete, but it is also vital that the government can use the multilateral system to generate value-added products and processes.[110]

Arguably, intervention in which the government not only protects businesses from competition but also subsidises nascent industries can be necessary. Subsidisation may allow African businesses to accumulate the necessary technology and know-how. Moreover, protection may incentivise firms to enter into a new industry, resulting in the enhancement of a firm's competitiveness. However, while it may assist in the development of infant industries, subsidisation may also have negative impacts on competition on the market.

2.4 The impact of subsidies on competition

[105] *Ibid.*
[106] *Ibid.*
[107] *Ibid.*
[108] Multilateralism refers to the relationship or alliance between countries that aim to pursue a common goal. In international trade, this, refers to the global trading system embodied in the WTO, where the common goal is to achieve more liberalised trade and trade on a non-discriminatory basis. See D Barry and RC Keith *Regionalism, Multilateralism, and the Politics of Global Trade* (1999) 3.
[109] *Ibid.*
[110] *Ibid.*

2.4.1 The goals of competition

The primary role of competition law is to promote and preserve competition as a mechanism to achieve the efficient allocation of resources. Furthermore, it aims to safeguard such competition against anti-competitive practices such as the abuse of dominance,[111] and collusion,[112] among competitors.[113] This protects the integrity of the market and its functionality in promoting the development of a country. This is important because markets are necessary if people are to procure the resources required to advance and protect human rights and, in turn, promote development.[114] The process of competition ensures that these resources remain obtainable at prices that consumers can afford to pay.

To facilitate its role, competition law has traditionally aimed at achieving several goals. The first of these is efficiency within the market.[115] This goal is meant to ensure that competition pushes firms to produce high-quality products while ensuring that prices for such products are kept as low as possible. Ensuring that markets remain efficient entails preventing and punishing anti-competitive behaviour that has the effect of substantially lessening or eliminating competition.[116]

The second of these goals is to eliminate companies' abuse of their dominance in the market. As discussed in Chapter 1, this involves preventing companies which enjoy substantial market power from engaging in practices that result in its abuse and is discussed later in this section.[117] These goals ensure that markets remain efficient and can maximise consumer welfare. This section discusses how subsidies prevent these goals from being fulfilled by substantially lessening or even eliminating competition from the market.

2.4.2 The role of African states' competitiveness in the AfCFTA

[111] A firm is considered to be dominant in the relevant market when its share of the mark*et al*lows it to exercise market power by either controlling prices, excluding competition from the market, or acting independently of its competitors, suppliers, or consumers. See RS Khemani *A Framework for the Design and Implementation of Competition Law* (1999) 71; P Sutherland and K Kemp *Competition Law of South Africa* (2000) 7-27.

[112] Collusion occurs when firms in the market co-operate rather than compete with each other. It usually takes the form of price-fixing or bid-rigging. See Sutherland and Kemp *Competition Law of South Africa* 5-3.

[113] U Aydin & T Büthe "Competition Law & Policy in Developing Countries: Explaining Variations in Outcomes; Exploring Possibilities and Limits" (2016) 79 *Law and Contemporary Problems* 1 at 4.

[114] KT Do "Competition Law and Policy and Economic Development in Developing Countries" (2011) 8 *Manchester Journal of International Economic Law* 18 at 26.

[115] Aydin & Büthe 2016 *Law and Contemporary Problems* 6; JB Rittaler *Industrial Concentration and the Chicago School of Antitrust Analysis: A Critical Evaluation on the Basis of Effective Competition* (1989) 40; M Neuhoff *et al A Practical Guide to the South African Competition Act* 2ed (2017) 6.

[116] *Ibid.*

[117] D Geradin "Competition Law an Regional Economic Integration: An Analysis of the Southern Mediterranean Countries" 2004 *World Bank Working Paper No. 35* 1 at 18.

Competitiveness can be defined at both the firm and the country level. At the firm level, competitiveness refers to the ability of a firm to trade their products or services in domestic and international markets.[118] At the country level, competitiveness refers to the level of prosperity that an economy can achieve based on how productive it is.[119] Such productivity is determined by factors such as the institutions the country has, such as a competition authority, and the government's policies.[120] Ultimately, competitiveness is a measure of whether a firm can produce and trade manufactured goods in both local and foreign markets competitively.[121]

A country's level of competitiveness determines the extent to which its markets can maximise welfare and prosperity in the economy.[122] A high level of competitiveness implies that a country's manufacturing sector has become more productive and improved exports of manufactured products.[123] This not only increases exports of manufactured products generally, but it also increases the diversity of such exports. Moreover, an increase in competitiveness implies that a country's economy is no longer dependent primarily on commodities, which can be sensitive to price fluctuations. Ultimately, increased competitiveness ensures that an economy is more resilient to external shocks.[124]

African countries have not only experienced low levels of competitiveness, but most of them are undergoing deindustrialisation.[125] This is primarily because commodities predominantly drive African economies, and demand for resources such as oil and gold has provided little incentive for them to diversify the products they export to the rest of the world. The reliance on commodities means that African countries either struggle to diversify their exports or simply lack the incentive to do so. Consequently, they struggle to remain competitive in

[118] United Nations Industrial Development Organization "Competitive Industrial Performance Report 2018" 2018 9 at 9.
[119] *Ibid.*
[120] *Ibid.*
[121] United Nations Economic Commission for Africa *et al* 2016 53.
[122] United Nations Economic Commission for Africa *et al* 2016 54.
[123] United Nations Economic Commission for Africa *et al* 2018 10.
[124] *Ibid.*
[125] United Nations Economic Commission for Africa *et al* 2016 53; United Nations Industrial Development Organization 2018 57. Deindustrialisation occurs when the share of manufacturing in a country's GDP decreases. In Africa, this is currently being experienced most by countries in the Sub-Saharan region. See F Tregenna "Deindustrialisation, Structural Change and Sustainable Growth" 2015 *UNIDO Research, Statistics, and Industrial Policy Branch Working Paper 2/2015* 2 at 7; R Grabowski "Deindustrialisation in Africa" (2015) 3 *International Journal of African Development* 51 at 52.

global markets. Ultimately, this means that African economies remain relatively small and that African countries are unable to influence global product prices in their favour.[126]

Therefore, increasing competitiveness is essential for achieving the AfCFTA Agreement's objectives. According to Article 3(e) of the AfCFTA Agreement, one of the general objectives of the AfCFTA is to enhance the competitiveness of members' economies within the continent and globally. This makes it imperative for governments to design policies that will develop their ability to produce and export products other than commodities. Considering how expensive intra-African trade is, such policies will have to equip local firms to produce goods while ensuring that they are given adequate incentive to export to African and global markets.

Furthermore, according to Article 3(f) of the AfCFTA Agreement, one of the general objectives of the AfCFTA is to promote industrial development through, *inter alia*, diversification and regional value chain development. To the extent that increasing a country's competitiveness improves its manufacturing sector, competitiveness forms an integral part of a nation's industrial development. In this context, AfCFTA members have to implement policies that will ensure that their competitiveness is not compromised or does not decline.

Enabling competition is vital for countries to achieve industrial development because there is a link between market competition and growth. This is because a competitive market increases the productivity of firms across the market.[127] When the intensity of competition is increased, firms are forced to innovate more, which means that they have to find ways to increase the quality of their products while ensuring that they keep production costs low.[128] Therefore, competition increases productivity and, in turn, contributes to a country's pace of industrialisation. Arguably, subsidies may either help facilitate the process of industrialisation or frustrate it because of their effects on competition in markets.

2.4.3 Effect of subsidies on competition

2.4.3.1 Government subsidies as public restraints on competition

[126] M Theodosiou and CS Katsikeas "Factors Influencing the Degree of International Pricing Strategy Standardization of Multinational Corporations" (2001) 9 *Journal of International Marketing* 1 at 6.
[127] DD Sokol *et al Competition Law and Development* (2013) 51.
[128] *Ibid.*

Public restraints are those practices or measures implemented by a government, as opposed to a private company, that limit competition in a particular market.[129] Subsidies are an example of such measures. By providing subsidies, governments distort the competitive process, because they reduce the budgetary constraints which would otherwise force firms operating in subsidised industries to be more innovative and, in turn, more efficient.[130] The protection provided by the government takes away a firm's incentive to increase its efficiency to remain in the market.[131]

Public restraints on competition can affect international trade and markets. For instance, export subsidies can allow domestic firms to shift their anti-competitive practices into international markets.[132] Export subsidies can be argued to have a double effect on competition. On the one hand, they allow firms to reduce barriers to entry into foreign markets by reducing the costs associated with such entry. For example, the European Communities (EC) implemented a sugar regime where sugar producers were granted "export refunds" on their export of certain sugar.[133] The subsidy covered the difference in price between the EC's internal market price and the world price for sugar, which allowed them to compete without losing profits.[134]

On the other hand, the protection from loss of profits means that both the subsidised firm and its competitor in some instances are disincentivised from innovating. Firms that face competition are often compelled to engage in R&D to obtain an advantage over their competitors or avoid competition entirely.[135] Therefore, a firm whose profits are secured by government funds is less inclined to work to stay in the market. Conversely, firms that expect to face the same amount of, or even more competition after innovating are less likely to invest in R&D.[136]

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[129] B Sweeney "Globalisation of Competition Law and Policy: Some Aspects of the Interface between Trade and Competition" (2004) 5 *Melbourne Journal of International Law* 375 at 381.
[130] DD Sokol "Limiting Anti-Competitive Government Interventions that Benefit Special Interests" 2009 *University of Florida Legal Studies Research Paper No. 2009-27* 1 at 4.
[131] *Ibid.*
[132] *Ibid.*
[133] Appellate Body Report, *European Communities – Export Subsidies on Sugar* (28 April 2005) WT/DS283/AB/R para 2
[134] *Ibid.*
[135] JB Baker "Beyond Schumpeter VS. Arrow: How Antitrust Fosters Innovation" (2007) 74 *Antitrust Law Journal* 575 at 579.
[136] Baker 2007 *Antitrust Law Journal* 580.

Firms competing with subsidised firms are unlikely to gain an advantage even if they innovate.[137] Subsidisation allows a firm to keep its costs low and keep prices down while maintaining their profits. Consequently, if competitors innovate, they are less likely to recover the costs of such innovation because they still have to keep their prices low enough to compete with a subsidised firm. As a result, the social benefits of innovation, which include products with enhanced quality and the increased living standard associated with that, are lost in the presence of subsidisation.[138]

Additionally, subsidisation limits foreign firms' ability to compete by creating barriers to entry. Protecting domestic industries through subsidies prevents market forces from reducing the market power of inefficient firms.[139] For example, the Turkish government implemented measures to localise a substantial part of the pharmaceutical products consumed in Turkey. To achieve this, the government required foreign producers to commit to localise the production of certain of their pharmaceutical products.[140] Foreign companies that did not give such a commitment, or that did not live up to their commitments were excluded from the reimbursement scheme designed to remunerate companies that committed.[141]

This matter represents a case in which the decision to subsidise a domestic industry has the potential to drive out foreign companies from competing in the domestic market. In this case, if a company's imported pharmaceutical products were excluded from the government's reimbursement scheme, its ability to compete with local firms would be seriously impaired.[142] The result is not only that the barrier insulates domestic firms from foreign competition that may threaten their position in the market, but it may potentially increase their market power by allowing them to operate in the absence of any competition.[143]

Some observations are apparent from the above analysis. To the extent that they can affect entry into an industry and partly insulate firms from the effects of competition, government subsidies constitute public restraints on competition. Furthermore, it can be concluded that beyond merely serving as public restraints on competition, government subsidies may also

[137] *Ibid.*
[138] *Ibid.*
[139] Sokol 2009 *University of Florida Legal Studies Research Paper No. 2009-27* 5.
[140] Request for Consultations by the European Union, *Turkey – Certain Measures Concerning the Production, Importation and Marketing of Pharmaceutical Products* (10 April 2019) WT/DS583/1, G/L/1305/ G/TRIMS/D/44, IP/D/41/ G/SCM/D126/1 para 1.
[141] *Ibid.*
[142] *Ibid.*
[143] Sokol 2009 *University of Florida Legal Studies Research Paper No. 2009-27* 5.

affect the market power that firms hold in specific industries. This means that subsidisation can enable private restraints on competition when companies can protect themselves from competition. These private restraints are tackled in the next section.

2.4.3.2 Government subsidies as anti-competitive restraints at the firm level

In the ordinary course of events, competition has the effect that where a market has multiple competitors and where products are differentiated, firms in the market will invest in R&D to increase their market share and deter new competitors from entering the market.[144] It has been discussed above how subsidies stifle this process. This analysis is expanded on in this part by showing how subsidies can have the effect of increasing firms' market power and enhancing such firms' chances of abusing their market power.

Market power refers to the ability of a firm to determine its prices and act independently of its competitors and suppliers.[145] A firm's market power is measured in terms of a company's market share and the degree of market concentration.[146] The pursuit of market power is the ultimate goal of firms which engage in competition because businesses naturally strive to achieve the ability to control their pricing decisions.[147] Therefore, it is the abuse of a firm's market power that is at the centre of its anti-competitive behaviour and not the mere possession thereof.

Subsidised firms can increase their market share, not because they have a legitimate advantage over their competitors, but because subsidies artificially reduce producers' costs. This allows firms to reduce the prices of their products below their market value.[148] Being insulated from having to price-to-market is an example of how subsidies help firms acquire significant market power. Pricing-to-market is a process by which a firm sets the prices of its products differently depending on the destination market of its goods.[149] In the absence of a subsidy, the ability to price-to-market depends on a firm's market power, because the latter affects the firm's ability to compete in international markets.

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[144] J Klaaren *et al Competition Law and Economic Regulation: Addressing Market Power in Southern Africa* (2017) 271.

[145] Sutherland and Kemp *Competition Law of South Africa* 7-26. See Neuhoff *et al South African Competition Act* 27.

[146] Klaaren *et al Competition Law* 238. Market Concentration refers to the number and the relative size distribution of firms. See Neuhoff *et al South African Competition Act* 50.

[147] Neuhoff *et al South African Competition Act* 29.

[148] DJ Boudreaux "Do Subsidies Justify Retaliatory Protectionism?" 2011 *Institute of Economic Affairs* 4 at 4.

[149] A Asprilla *et al* "Trade policy and Market Power: Firm-Level Evidence" (2019) 60 *International Economic Review* 1647 at 1648.

For instance, a firm may intend to export its goods to different countries and be met with an "exchange rate shock".[150] When a firm's goods enter the intended market, a fraction of the shock is absorbed by the firm, which means that the increase in the value of the currency in the destination market must be factored into the firm's production costs.[151] Consequently, the overall price of the product is affected because of the costs that the firm had to absorb. In such circumstances, a firm would price-to-market.[152] A subsidy insulates a firm from having to price-to-market because it would allow it to recoup any losses arising from the shock and, in some cases, increase its profits.

The above-mentioned example illustrates that the use of subsidies can facilitate a firm's acquisition of market power. Using subsidies to absorb costs that would otherwise raise the costs of a firm's goods allows it to price its goods competitively.[153] It also allows firms to set prices below the market price because it is under no pressure to remain competitive.[154] The result is that the firm can significantly increase its market share of the product in question. Furthermore, the real effect of a subsidy is that it places the subsidised firm in a position where the market and competitive forces do not have a significant impact on its decisions.[155] This increases the risk of anti-competitive market conduct.[156]

Anti-competitive market conduct occurs when a firm abuses its market power or engages in conduct that substantially lessens competition, thereby harming both its consumers and its competitors.[157] When the government subsidises a firm, it may result in anti-competitive market conduct. Subsidies increase the risk of predatory pricing in markets.[158] Predatory pricing may occur in the domestic market, where a subsidy allows local firms to price their goods below marginal costs to effectively drive both local and foreign competitors out of the

[150] *Ibid.* An exchange rate shock occurs when the value of one currency increases in comparison to another currency over a short period. See T Nath "Exchange Rate Shocks: What they Are and How They Affect You" https://www.nasdaq.com/articles/exchange-rate-shocks-what-they-are-and-how-they-affect-you-2016-04-25 (Accessed 11 June 2020).
[151] Asprilla *et al* 2019 *International Economic Review* 1648.
[152] *Ibid.*
[153] HM Treasury "Guidance on How to Assess the Competition Effects of Subsidies" (2007) *Office of Fair Trading* 4 at 11.
[154] *Ibid.*
[155] *Ibid.*
[156] *Ibid.*
[157] Neuhoff *et al South African Competition Act* 53.
[158] Predatory pricing refers to the process of selling goods below their marginal value with the intention of driving competitors out of the market. See Neuhoff *et al South African Competition Act* 157; Sutherland and Kemp *Competition Law of South Africa* 7-100.

market. It may also occur in foreign markets, where an export subsidy allows foreign firms to drive local firms out of the market.

The result of predation in both these scenarios is that it reduces the resources that competitors have to invest in innovation and sustain their operations.[159] When a subsidised firm can consistently keep its prices below market value, the value of a competitor's investment in research is diminished. This is because the investor is unlikely to recoup the costs of the investment at a later date. Therefore, a competitor is driven out of the market because it can no longer innovate, or because it has lost significant market share.[160] Ultimately, the subsidy affects the actions of other competitors in the market.[161]

Moreover, the innovation lost as a result of predation decreases consumer welfare in the market.[162] The consumers receive an efficiency gain through lower prices. However, despite lowering the prices which consumers pay for their goods, they limit the freedom that consumers have to choose between differentiated products by stifling research that allows competitors to develop diverse products for the market.[163] Ensuring that there is an efficient allocation of resources in markets requires not only that the price of a product is low, but also that the market can cater to the different needs that consumers have.[164] By stifling competition and driving out competitors from the market, subsidies decrease consumer welfare and constitute *prima facie* anti-competitive market conduct.[165]

2.5 The importance of the economic analysis in this study

Even though the benefits of liberalisation are apparent, trade protection still exists because of high tariff and non-tariff barriers that make it difficult for developing countries to improve on their terms of trade.[166] Market forces may not always be able to correct the effects of such restrictions on trade. Moreover, it is widely accepted that market failures may call for the

[159] DD Sokol "Competition Policy and Comparative Corporate Governance of State-Owned Enterprises" 2009 *Brigham Young University Law Review* 1713 at 1775.
[160] TP Stewart and TC Brightbill "Trade Law and Policy in Regional Trade Arrangements" (1996) 27 *Law and Policy in International Business* 937 at 941; Sutherland and Kemp *Competition Law of South Africa* 7-100.
[161] HM Treasury "Guidance on How to Assess the Competition Effects of Subsidies" (2007) 11.
[162] Sokol 2009 *Brigham Young University Law Review* 1775.
[163] Do 2011 *Manchester Journal of International Economic Law* 26.
[164] *Ibid.*
[165] YA Lee "Competition, Consumer Welfare, and the Social Cost of Monopoly" 2006 *Yale Law School Legal Scholarship Repository* 1 at 3.
[166] Hudec *Developing Countries in the GATT* 134.

government to intervene in the market to correct the particular failure, and that offering subsidies may be the most effective way to fix the failure.

This study is concerned with whether the current provisions that regulate prohibited subsidies align with the economic rationale which underpins their use, and whether it benefits countries in the AfCFTA. Considering that developing countries use subsidies as tools to promote their development and industrialisation, a pertinent question arises in light of the economic analysis carried out in this chapter: whether the AfCFTA can effectively regulate the impact of export subsidies and local content subsidies or whether alternatives to the AfCFTA's current subsidy regime should be considered.

Therefore, if an argument can be made that prohibited subsidies are capable of enhancing the welfare of consumers and producers, it should be worth considering that prohibiting such subsidies without the ability to justify their use may not be effective. This is because such regulation would be occurring in a context where prohibition is made absolute without an analysis of the effects of each subsidy on the market.

2.6 Conclusion

Markets in Africa contain plenty of distortions that call for the government to intervene to correct market failures. In such cases, government subsidies may allow the government to effectively correct market failures or even protect infant industries which might suffer without any intervention. Africa needs to improve its competitiveness and the role that the process of competition plays in achieving that. In this light, the discussion highlights how the use of prohibited subsidies may hamper the continent's ability to achieve such competitiveness by distorting competition through public restraints and the private restraints that they enable. Finally, the economic analysis in this chapter lays an essential foundation for the next chapter, which discusses whether the regulation of prohibited subsidies in the AfCFTA, in light of this analysis, is effective.

Chapter 3: The regulation of subsidies in the AfCFTA

3.1 Introduction

The provisions of the AfCFTA Agreement that deal with the use of government subsidies have been discussed in the introductory chapter. This chapter entails an analysis of how subsidies are regulated in the AfCFTA. The chapter specifically focuses on the prohibition on export subsidies and local content subsidies. Ultimately the goal of the analysis carried out in this chapter is to determine whether Annex 9,[1] and the Guidelines,[2] effectively regulate the use of prohibited subsidies by AfCFTA member states.

This chapter discusses the AfCFTA provisions on subsidies expansively. The first part of this chapter provides an overview of the definition of a subsidy that is provided in the introductory chapter. It specifically focuses on the determination of a benefit by the investigating authority. The second part is a discussion of the requirement of specificity in the Guidelines, which assists in determining if a subsidy might be trade-distorting. The third part involves an assessment of the regulations dealing with prohibited subsidies, the rationale thereof, and some examples of their use in developing countries and some states within the AfCFTA. The final part deals with the effectiveness of the Guidelines in regulating prohibited subsidies.

3.2 The AfCFTA framework of subsidy regulation

3.2.1 The definition of a subsidy

3.2.1.1 The requirement of a financial contribution or income or price support

Whether a government measure provides a financial contribution depends on the form that the measure takes. This means that a measure must constitute at least one of the measures listed in Guideline 28.1(a), which states that "there is a financial contribution by a government or any public body within the territory of a government of a Party, where:

i. a government or public body provides a direct transfer of funds;
ii. government revenue that is otherwise due is foregone or not collected;

[1] Annex 9 on Trade Remedies.
[2] AfCFTA Guidelines on the Implementation of Trade Remedies.

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 (ii) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by government."

Since the definition of a subsidy has been taken verbatim from the SCM Agreement, it is inferred in this study that the interpretation thereof will be carried out in the same way as in WTO law. Much like Article 1.1 of the SCM Agreement, the language in Guideline 28 indicates that the list of measures mentioned is exhaustive, and measures falling outside this list will not constitute a financial contribution.[3] Additionally, the already broad list of measures covered by Guideline 28(a) is broadened even further by the addition of income or price support,[4] in Guideline 28.1(b).

Income or price support occurs when a government attempts to stabilise the domestic price of a product by encouraging the export of such product at prices that are lower than the price charged in the domestic market to buyers of like products.[5] This has the effect of directly or indirectly increasing exports of a product from, or reduce imports of a product into, a member state's territory.[6] This measure contemplates a system where a government encourages firms to export products into international markets independently of market forces.[7] The effect of such measures is to distort the market by setting prices that do not correspond with the prevailing market conditions at a particular time.

3.2.1.2 The financial contribution must confer a benefit.

Guideline 28.1(c) requires that a financial contribution by a government must confer a benefit to the recipient thereof. While the existence of a financial contribution is examined from the

[3] This was confirmed in Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Softwood Lumber from Canada* (19 January 2004) WT/DS257/AB/R para 52. For instance, a tax rebate that does not exceed the amount that has accrued will not constitute a financial contribution.
[4] *Ibid.*
[5] WTO Analytical Index "GATT 1994 – Article XVI (Jurisprudence)" (June 2020) 1 at 2.
[6] *World Trade Organisation* 2006 *WTO Publications* 53.
[7] Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products* (17 May 1999) WT/DS113/R para 4.344.

perspective of the government implementing the measure in question, the existence of a benefit is examined from the perspective of the firm that receives such contribution.[8] Both the financial contribution and the conferral of a benefit must take place for a measure to constitute a subsidy.[9] If a financial contribution is provided, but a benefit is not conferred on the recipient, the measure will not be subject to regulation because it is not a subsidy, and thus lacks the potential to distort international trade.[10]

Whether a benefit has been conferred depends on whether the financial contribution leaves the recipient in a better position than it would have been were it not for the contribution.[11] This requires an analysis of whether the financial contribution was made on terms that are more favourable to the recipient than those currently available in the market.[12] For instance, if a government provides a loan to a firm at interest rates that are lower than the standard rates available in the market, this may constitute a subsidy. The loan represents a financial contribution and leaves the firm better off because of the lower interest rate payable, which would not be available to the firm under normal market conditions.[13]

Subsidy disciplines aim to reduce governments' ability to intervene in markets in ways that distort competitive relationships.[14] This understanding of subsidy rules is the reason that the existence of a benefit is determined by comparing the position of the recipient of the subsidy in the 'relevant market',[15] in which the recipients compete.[16] In essence, unless the relevant market is defined, the existence of a benefit cannot be determined.[17]

Therefore, determining whether a benefit has been conferred requires both a definition of the relevant market in which the financial contribution was made and an analysis of that

[8] M Matsushita *et al World Trade Organisation: Law, Practice and Policy* 3ed (2015) 316.
[9] *Ibid.*
[10] Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea* (17 June 2005) WT/DS299/R para 7.175.
[11] HB Asmelash "Energy Subsidies and WTO Dispute Settlement: Why Only Renewable Energy Subsidies are Challenged" (2015) 18 *Journal of International Economic Law* 261 at 271.
[12] Asmelash 2015 *Journal of International Economic Law* 271; RE Lee "Dogfight: Criticising the Agreement on Subsidies and Countervailing Measures Amidst the Largest Dispute in *World Trade Organisation* History" (2006) 32 *North Carolina Journal of International Law and Commercial Regulation* 115 at 128.
[13] See Appellate Body Report, *United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)* (12 March 2012) WT/DS353/AB/R paras 616-617.
[14] Matsushita *et al World Trade Organisation* 320.
[15] The relevant market refers to the market in which the anti-competitive conduct in question occurs. See P Sutherland and K Kemp *Competition Law of South Africa* (2000) 7-16.
[16] ABR, *Canada – Aircraft* para 157.
[17] ABR, *Canada – Renewable Energy/FIT* para 5.169.

particular market.[18] The rationale behind this is to regulate the behaviour of firms within markets, as there needs to be an understanding of the practical context within which that behaviour happens.[19] This means that the existence of a benefit depends on the context in which the financial contribution was made. Ultimately, where a complaint is raised against a government for allegedly providing subsidies in contravention of the Guidelines, the relevant market must be defined before the impact of the government's economic behaviour can be assessed.

A distinction is drawn between government measures that distort already-existing markets and those that create new markets.[20] Analysing the existence of a benefit in a market that already exists helps determine whether there has been a distortion of that market by the government intervention in question. Where the market is created because of the intervention, a distortion cannot be argued to exist, because the market itself would not exist if there were no intervention.[21] Since a subsidies dispute has not yet come before the AfCFTA Dispute Settlement Body, it remains to be seen whether the jurisprudence in the AfCFTA will follow this line of interpretation.

3.2.2 The requirement for specificity

A subsidy only falls under the scope of the Guidelines if it targets specific firms.[22] Particularly, the subsidy must be specific to certain enterprises and not widely available within a market.[23] A complainant will not be able to take action against a member that implements a subsidy unless such a subsidy is specific in accordance with Guideline 29, which sets out the principles governing whether a subsidy is specific.[24] According to Guideline 29.1:

> "In order to determine whether a subsidy, as defined in Guideline 28, is specific to an enterprise or industry or group of enterprises or industries, referred to in

[18] ABR, *Canada – Renewable Energy/FIT* para 5.164.
[19] H Kalimo *et al* "Market Definition as Value Reconciliation: The Case of Renewable Energy Promotion Under the WTO Agreement on Subsidies and Countervailing Measures" (2017) 17 *International Environmental Agreements* 427 at 429.
[20] ABR, *Canada – Renewable Energy/FIT* para 5.118.
[21] Asmelash 2015 *Journal of International Economic Law* 272
[22] Matsushita *et al World Trade Organisation* 300.
[23] P Van den Bossche and D Prévost *Essentials of WTO Law* (2016) 162.
[24] Matsushita *et al World Trade Organisation* 325.

this Guideline as "certain enterprises", within the jurisdiction of the granting authority, the following principles shall apply:

a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific;
b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official documents, so as to be capable of verification;
c) If notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy. In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation; and
d) A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific. It is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Guideline."

Guideline 29.2 further states that a subsidy is specific and prohibited if it is contingent in law or fact, upon export performance or the use of domestic over imported goods. In essence, specificity relates to whether eligibility to receive a subsidy is limited to specific enterprises,

and not whether the subsidy is granted to certain enterprises.[25] Therefore, if the subsidy is granted to specific enterprises, but the criteria for eligibility are objective, the subsidy is not specific because their eligibility to receive the subsidy is not limited only to the enterprises that receive it.

Guideline 29.1 categorizes three types of subsidies as specific without having to examine and further if they meet the requirements for specificity: (i) subsidies that are limited to enterprises found within a particular geographical location; (i) export subsidies; and (iii) local content subsidies.[26] This means that if a subsidy does not fall into any of these categories, the complainant state must prove that one or more of the principles in this provision applies to the subsidy. Guideline 29.3 requires that a determination of specificity must be substantiated by evidence.

The specificity enquiry encompasses a two-tiered test. The first part of the test focuses on whether a subsidy is specific to certain enterprises within the territory of the granting authority.[27] The second tier requires an application of the principles in subparagraphs (a)-(c) to the subsidy.[28] Subparagraphs (a) and (b) require an assessment of the indicators of eligibility for a subsidy. The purpose of subparagraphs (a) and (b) is to limit the scrutiny of a subsidy to the eligibility requirements imposed by the granting authority or the instrument that empowers the granting authority.[29]

Specifically, subparagraph (a) is concerned with whether there is a limitation on whom can access the subsidy. In contrast, subparagraph (b) involves an examination of whether objective criteria govern both the eligibility for and the amount of the subsidy.[30] The principles in subparagraphs (a) through (c) must be considered concurrently, with appropriate weight being accorded to each principle based on the circumstances of the matter in question.[31] Such an approach suggests that a subsidy can contain characteristics that indicate

[25] *Ibid.*
[26] Matsushita *et al World Trade Organisation* 326.
[27] Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain products from China* (11 March 2011) WT/DS379/AB/R para 366. Although this is a WTO matter in which the conditions for specificity were interpreted, it is argued that a similar interpretation may be adopted in the AfCFTA.
[28] *Ibid.*
[29] ABR, *US – Anti-Dumping and Countervailing Duties (China)* para 368.
[30] *Ibid.*
[31] ABR, *US – Anti-Dumping and Countervailing Duties (China)* para 366.

that it falls under Guideline 29.1(a) as well as those that indicate that it falls under Guideline 29.1(b).[32]

In such a case, subparagraph (c) requires that despite "any appearance of non-specificity" arising from the application of subparagraphs (a) and (b), the factors in subparagraph (c) can be applied to the factual circumstances surrounding the challenged subsidy.[33] In essence, the application of the principles allows both the legal and factual aspects of a subsidy to be examined to determine whether access to the subsidy is limited.[34] Therefore, it is argued that the requirements for specificity capture two situations. Firstly, they cover situations where the eligibility requirements of the subsidy indicate that it is specific. Secondly, they cover situations where the application of the subsidy indicates that it is specific even though the eligibility requirements indicate non-specificity.

Ultimately, the rationale behind specificity is that it distinguishes between subsidies that distort the allocation of resources in markets and those that do not.[35] Therefore, unless a subsidy is specific, it is not presumed to distort the allocation of resources within a market. It is argued that the effect of this provision is to prevent disputes from being initiated just on the basis that a measure implemented by a government constitutes a subsidy.

3.2.3 Prohibited Subsidies

According to Guideline 29.2, "a subsidy is prohibited where it is contingent in law or fact, whether solely or as one of several other conditions, upon export performance or the use of domestic over imported goods". The former is known as an export subsidy, while the latter is referred to as a local/domestic content subsidy. Such subsidies are specifically designed to affect trade, whether by promoting exportation or by supporting domestic industries and manufacturing by requiring firms to use local content.[36] The result is that they restrict trade, are anti-competitive, and they are harmful to the development of third countries.[37]

3.2.3.1 Local content subsidies

[32] ABR, *US – Anti-Dumping and Countervailing Duties (China)* para 369.
[33] ABR, *US – Anti-Dumping and Countervailing Duties (China)* para 370. It must be noted, as held in paragraph 371 of this Report, Subparagraph (c) only applies when there is an appearance of non-specificity.
[34] ABR, *US – Anti-Dumping and Countervailing Duties (China)* para 371.
[35] *Ibid.*
[36] Lee 2006 *North Carolina Journal of International Law and Commercial Regulation* 129.
[37] G Horlick and PA Clarke "Rethinking Subsidy Disciplines for the Future: Policy Options for Reform" (2017) 20 *Journal of International Economic Law* 673 at 681.

Local content subsidies require that a firm purchase a certain amount of the input they use to create their product from the domestic market instead of importing it.[38] A country may apply such requirements to promote infant industries by ensuring that they secure sales and can build up the capacity to compete domestically and internationally.[39] Therefore, one of the main aims of using local content subsidies is to improve domestic manufacturing in a country without the government directly bearing the financial burden thereof. India's solar energy programme is an example of the use of local content subsidies by a developing country that has been subject to a legal dispute.[40]

In 2010, the Indian central government launched a National Solar Mission (NSM), the purpose of which was to establish India as a global leader in solar energy by creating the conditions necessary for it to be used across the country as quickly as possible.[41] The NSM was intended to facilitate India's transition to using electricity generated by solar power. The NSM is being implemented in different phases, which are further divided into batches, with each phase consisting of different domestic requirements. For instance, under the first batch, solar power developers were mandated to use crystalline silicon modules, manufactured in India for all projects based on crystalline silicon technology.[42]

Solar power developers entered into power purchasing agreements (PPAs) with the Indian government. According to the PPAs, the government set out a guaranteed rate for 25 years, at which it would buy electricity generated by the solar power developer.[43] In this sense, the purchase of the electricity by the government was conditional on the solar power producers' use of domestic over imported products. However, the complaint brought against India was for a violation of Article III:4 of the GATT and Article 2.1 of the Agreement on Trade-Related Investment Measures (TRIMS Agreement) and not the SCM Agreement.

Although this dispute was not about a local content subsidy, it illustrates the effect of local content requirements. The problem with providing such a subsidy is that while it increases welfare for local manufacturers, it does so at the expense of firms that export their products

[38] O Johnson "Promoting Green Industrial Development Through Local Content Requirements: India's Solar Mission" (2016) 16 *Climate Policy* 178 at 180.
[39] *Ibid.*
[40] India is used as an example to illustrate the use of local content requirements in developing countries, as there is a lack of any documented use of local content requirements by countries in the AfCFTA.
[41] ABR, *India – Solar Cells* para 1.2.
[42] ABR, *India – Solar Cells* para 1.5.
[43] ABR, *India – Solar Cells* para 1.3.

into a subsidised country.[44] Furthermore, it may also harm domestic producers that do adhere to the requirements set out by preventing them from competing effectively in the market.[45] Therefore, these subsidies are prohibited because they have the effect of restricting imports into a country's economy.

3.2.3.2 Export Subsidies

The purpose of an export subsidy is to promote the production of goods for exportation into international markets. Therefore, the purpose of the subsidy is to reduce the costs of exportation and, in turn, increase the producer's profits. However, it is argued that export subsidies have the opposite effect. While export subsidies benefit consumers of the exported goods, they harm industries that compete with the subsidised sector.[46] Specifically, export subsidies tend to have the effect of increasing domestic prices of a product because the incentive to export goods often results in a decreased supply to the local market.[47] Therefore, these subsidies are viewed as the most trade-distortive subsidies.

3.2.3.3 Export Processing Zones: an example of the use of export subsidies within AfCFTA member states.

The creation of EPZs is a policy tool that has been employed by governments in the early stages of their economic development to stimulate economic activities in certain parts of their economies. An EPZ is a geographically limited area in a country in which the economic activities held are exempt from the laws and other regulations that are in force in the rest of the country.[48] The goals of EPZs include creating jobs to reduce unemployment rates, to promote the manufacturing of goods for exportation as well as the diversification of a country's exports, and to attract foreign direct investment (FDI) into a country.[49]

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[44] Horlick and Clarke 2017 *Journal of International Economic Law* 682.
[45] *Ibid.*
[46] Horlick and Clarke 2017 *Journal of International Economic Law* 685.
[47] Horlick and Clarke 2017 *Journal of International Economic Law* 682; P Finckenberg-Broman *The Many Facets of Export Subsidies in WTO* (Bachelors Thesis, Lund University, 2012) 28.
[48] WP Chirwa *The Regulation of Subsidies and Regional Trade Among Developing Countries in the Multilateral Trading System: The Case of Export Processing Zones in Malawi* (LLM Thesis, Rhodes University, 2017) 6.
[49] Chirwa *The Regulation of Subsidies* 7; NC Rotich *Assessing Kenya's Free Zones Consistency with WTO Agreements on Subsidies and Countervailing Measures and Agriculture* (LLM Thesis, University of Pretoria, 2019) 1.

Governments primarily establish EPZs for two reasons. First, developing countries often lack the kind of business environment necessary to attract FDI in their activities.[50] This is because such countries lack the institutions required to create a thriving business environment. The existence of such an environment is essential because one of the criteria affecting whether businesses invest in a country is whether the country has attractive economic incentives.[51] Therefore, EPZs seek to provide such incentives. Second, EPZs are one of the tools that a government may use to direct economic activity to specific parts of a country that need it. This way, governments can stimulate particular areas of a country.

Governments attract investors to EPZs by offering fiscal incentives.[52] Examples of such reductions include tax holidays, exemptions from income tax, reductions of the amount of corporate tax that companies are required to pay for a certain period, and exemptions from value-added tax.[53] Incentives in the form of tax reductions are essential for foreign investors because they affect the profits that their companies make and, in turn, whether they are willing to invest in a specific country. Ultimately, EPZs are a *quid pro quo*, where investor companies receive fiscal benefits in exchange for helping to facilitate economic growth and development in an area.[54]

Several examples of EPZs in AfCFTA member-states are worth mentioning. The first is Kenya, where EPZs are established according to the Export Processing Zones Act.[55] According to ss 29(2) of this Act, the benefits granted to enterprises in EPZs include, *inter alia*, exemptions from registration for value-added tax, excise duties, income tax and withholding taxes on dividends. The second is Malawi, where an Export Processing Zones Act also establishes EPZs.[56] This Act provides enterprises in EPZs similar benefits as those that are found in Kenyan EPZs.[57] The long-term goal of the legislation is to transform

[50] H Christian and AW Schulze "Free Trade Zones at the beginning of the 21st Century" (2002) 35 *CILSA* 198 at 199.
[51] JJ Waters "Achieving *World Trade Organisation* Compliance for Export Processing Zones While Maintaining Economic Competitiveness for Developing Countries" (2013) 63 *Duke Law Journal* 481 at 490.
[52] A fiscal incentive is a tax reduction for investors . See Christian and Schulze 2002 *CILSA* 200.
[53] Christian and Schulze 2002 *CILSA* 200; Rotich *Assessing Kenya's Free Trade Zones* 2.
[54] Waters 2013 *Duke Law Journal* 489.
[55] Act 12 of 1990.
[56] Act 11 of 1995.
[57] See ss 15B (1) of the Act.

Malawi into a net exporter by providing a conducive environment, which will eventually enable export promotion.[58]

Even though EPZs are industrial tools that form an integral part of developing countries' development, they may fall foul of Guideline 29.2. The reason is that the fiscal incentives used by governments to attract investors into the EPZs constitute subsidies under Guideline 28. Tax exemptions not only constitute government revenue that is foregone or not collected, but they result in firms in an EPZ having advantages over their competitors in the market because of more favourable conditions.

The result is that these measures constitute export subsidies because the receipt of the subsidy is *de facto* contingent on the export performance of firms within the EPZs.[59] The studies referred to in the case of EPZs were carried out based on the provisions of the SCM Agreement. However, had these measures been examined under the Guidelines, they would also constitute export subsidies. The result is that the governments implementing the measures would be obligated to withdraw them or be subjected to countervailing duties by the country affected by the subsidies.

While it is not in doubt that these measures would also violate provisions of the Guidelines, the critical difference between the AfCFTA Agreement and the SCM Agreement is that the latter explicitly provides for special and differential treatment of developing countries.[60] This means that Kenya and Malawi may be able to justify their subsidy programmes on the basis that they are developing countries, subject to the provisions in the SCM Agreement. Therefore, the question is whether these special and differential provisions are available for AfCFTA member states under the AfCFTA Agreement and the Protocol on Goods. This question is addressed in the next chapter.

3.2.4 Remedies

The AfCFTA Agreement allows for three kinds of responses to subsidies. First, Article 7.2 of the Dispute Settlement Protocol allows a complainant state to initiate consultations between the parties to a dispute to discuss the measures in question and resolve the dispute amicably.

[58] Chirwa *The Regulation of Subsidies* 7.
[59] Rotich *Assessing Kenya's Free Trade Zones* 32; Chirwa *The Regulation of Subsidies* 76.
[60] Special and differential provisions are contained in Article 27 of the SCM Agreement and are discussed in chapter 4.

Second, according to Article 7.8 of the Dispute Settlement Protocol, where parties cannot resolve the dispute through consultations, the complainant may refer the dispute to the AfCFTA Dispute Settlement Body. The Dispute Settlement Body will establish a Panel to adjudicate the matter to determine whether the measure is a subsidy and whether it should be withdrawn.

Third, Article 16.1 of Annex 9 allows member states to use a trade remedy against competitors that receive government subsidies. Trade remedies are measures implemented by member states to defend their local producers in certain circumstances, such as when imported goods have been subsidised.[61] The trade remedy against subsidies is known as a countervailing measure. [62] Countervailing measures are additional duties imposed on subsidised imports from another country to address the trade-distorting effects of the subsidies.[63]

A complainant state may impose countervailing duties after having made reasonable efforts to complete consultations with a respondent state, and after a final determination of the existence and amount of a subsidy has been made.[64] Guidelines 28 and 29 are invoked to determine whether benefits provided by member states constitute subsidies that infringe upon the AfCFTA Agreement before a complainant state can implement countervailing measures. Guideline 33 contains provisions on the calculation of the amount of a subsidy to determine how much a firm has benefitted in the market.

3.3 The effectiveness of the AfCFTA Agreement in regulating subsidies

3.3.1 An overview of the relevant provisions of the Protocol on Goods

In the AfCFTA, trade in goods is regulated by the AfCFTA Protocol on Goods. The Protocol has 32 Articles that cover a variety of subjects related to the trade in goods. Furthermore, the Protocol is accompanied by nine annexes that form an integral part of the Protocol because

[61] I Ousseni "Trade Remedies in Africa: Experience, Challenges and Prospects" 2012 *GEG Working Paper, No. 2012/70* 1 at 1.
[62] Article 2 of Annex 9.
[63] G Erasmus "Are Trade Remedies Important for Achieving AfCFTA Goals?" https://www.tralac.org/blog/article/12764-are-trade-remedies-important-for-achieving-the-afcfta-goals.html (accessed 30 January 2020).
[64] Guideline 38.

they expand on its general provisions.[65] Two parts of the Protocol on Goods are essential for this study because they relate to subsidies: (1) Annex 9 on Trade Remedies (Annex 9); and (2) Article 25 of the Protocol on Goods which deals with general exceptions.

3.3.1.1 Trade remedies

Trade remedies are instruments that allow member states to protect their domestic industries from harm caused by another member state through the use of measures such as subsidies.[66] Article 16.1 of the Protocol on Goods allows states to apply countervailing measures to subsidies. At the same time, Article 16.2 provides that the application of countervailing duties must be made in accordance with provisions of Annex 9.

Article 2 of Annex 9 states that all countervailing duty investigations must be carried according to the provisions of the SCM Agreement.[67] Provisions on countervailing measures come into force when a measure has been found to constitute a specific subsidy and where an aggrieved member state wishes to counteract the effect of the subsidy. The problem with countervailing duties is that their application could serve to deny market access benefits to businesses, whether the subsidy in place serves important policy goals or not.[68]

The result is that there is an inconsistency in the way that prohibited subsidies are regulated. It is no doubt that the availability of trade remedies provides relief and stability to companies that may experience unfair competition as a result of subsidies that distort trade and affect competitive relationships within the market.[69] However, the Protocol on Goods and Annex 9 do not allow for possibilities where the granting of subsidies may be according to a member state's socio-economic policy. Arguably, to the extent that a country that uses export and local content subsidies may face countermeasures without the need to assess the overall effect of the subsidy in the relevant market, the current subsidy regime treats AfCFTA members unfairly.

3.3.1.2 General exceptions

[65] Article 2.2 of the Protocol on Goods states that all the Annexes to the Protocol shall form an integral part thereof.
[66] International Trade Centre "A Business Guide to the African Continental Free Trade Area Agreement" 2018 *ITC, Geneva* iii at 20.
[67] The provisions specifically relating to countervailing duty investigations are beyond the scope of this study and they are therefore not discussed here.
[68] International Trade Centre 2018 *ITC, Geneva* 20.
[69] *Ibid.*

Article 25 of the Protocol on Goods contains general exceptions to the obligations imposed on AfCFTA members. According to this provision, states may implement measures that, *inter alia*, aim to conserve exhaustible natural resources, protect human, animal or plant life of health. This is "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 the same conditions prevail, or a disguised restriction on international trade".[70]

These exceptions are framed to replicate the general exceptions in Article XX of the GATT, which are discussed in chapter 4. The general exceptions are meant to provide member states with the space to deviate from the obligations imposed by the Protocol on Goods in pursuit of their policy objectives.[71] For the purpose of this section, only two points are essential. Firstly, Guideline 29.2 contains language which suggests that prohibited subsidies may not be capable of being justified using general exceptions. Therefore, it is unclear whether these general exceptions can be used to exempt subsidies that are inconsistent with Guideline 29.2.

Secondly, the importance of subsidies in developing infant industries and as a significant feature of EPZs has previously been explained in this thesis.[72] EPZs and the infant industry argument are essential to understanding why the uncertainty discussed in this section is important. Article 22.1 of the Protocol on Goods states that members of the AfCFTA may use special economic zones to accelerate their development. Furthermore, Article 23.1 of the Protocol on Goods states that for the purpose of protecting infant industries with strategic importance, a member state may implement measures to protect such an industry.

The inclusion of these Articles in the Protocol on Goods means that subsidies that are meant to protect an infant industry or form an important part of incentivising investment in a special economic zone may nonetheless have to be withdrawn for infringing Guideline 29.2. Consequently, the operation of these Articles may become redundant when subsidies are used in each of these cases. Therefore, the uncertainty about the applicability of the general exceptions,[73] means that there is an unpredictability about the amount of policy space that member states have to implement subsidies. Ultimately, this uncertainty means that the regulation of local content and export subsidies in the AfCFTA is ineffective to the extent

[70] Article 25 of the Protocol on Goods.
[71] International Trade Centre 2018 *ITC, Geneva* 22.
[72] See paragraphs 2.3.3.1 and 3.2.3.3 of this thesis.
[73] The applicability of general exceptions to subsidy provisions is discussed in the next chapter.

that their prohibition may prevent the implementation of other AfCFTA provisions, such as those listed above.

3.3.2 The impact of an absolute prohibition of local content and export subsidies on competition

One of the most crucial factors that determine whether there is a subsidy is whether a benefit has been conferred.[74] The effect of a subsidy in cases other than those involving prohibited subsidies depends mostly on the relevant market as a benchmark for determining whether unsubsidised firms have been adversely affected.[75] For instance, Guideline 30.2 allows a member state to initiate investigations upon written application to determine the existence, degree and effect of an alleged subsidy. This process depends on an analysis of the market in which the subsidised firm operates.

While prohibited subsidies often distort or even prevent competition, a blanket prohibition without any analysis of the impact of a specific measure in the market fails to take into account whether the measure addresses the market failure it is intended to correct.[76] Subsidies are tools used to achieve government objectives in markets, and they may sometimes be the most effective tool to achieve the government objective in question.[77] The current regime on subsidies prohibits a subsidy if it meets the criteria in Guideline 29.2 without any examination of its effects on the market because it is automatically assumed to distort trade.

The analysis of the rationale for subsidisation in the previous chapter shows that the reasons for subsidising an industry as well as the effects thereof are an important consideration.[78] The consideration is essential because there are circumstances where subsidisation may promote competition. An example of this is in the civil aircraft industry, where it is almost impossible for new competitors to enter the industry because of the high start-up costs associated with entering into the industry.[79] In such cases, government subsidies are the most effective way to

[74] Guideline 29.2 of the AfCFTA Guidelines on the Implementation of Trade Remedies.
[75] Kalimo *et al* 2017 *International Environmental Agreements* 429.
[76] A Cosbey and PC Mavroidis "A Turquoise Mess: Green Subsidies, Blue Industrial Policy and Renewable Energy: The Case for Redrafting the Subsidies Agreement of the WTO" 2014 *European University Institute Working Paper No. 473* 1 at 25.
[77] Cosbey and Mavroidis 2014 *European University Institute Working Paper No. 473* 24.
[78] Cosbey and Mavroidis 2014 *European University Institute Working Paper No. 473* 25.
[79] Lee 2006 *North Carolina Journal of International Law and Commercial Regulation* 151.

incentivise new competitors to enter the market because they make it possible for new entrants to obtain funding when banks and other companies are unwilling to provide such.[80]

For instance, this was the case when Brazil implemented an export financing programme for its export industry. The programme paid out a subsidy to Embraer, a manufacturer of aircrafts for its exports into international markets.[81] It subsidised businesses that borrowed money from banks in Brazil by paying up to 3.8 per cent of the interest charged by a bank for a loan, effectively reducing the costs associated with purchasing aircraft.[82] The result was that Embraer was able to increase its aircraft exports into international markets and compete with firms in those countries.

This example represents one of the cases in which it is difficult to enter into new markets without subsidisation as an incentive. Moreover, this analysis is of relevance for AfCFTA member states. In the introductory chapter, it is explained that the costs associated with intra-African trade often disincentivises firms from trading within the continent. Subsidisation may help firms deal with such costs better, and even incentivise them to export into new markets within the continent.[83] However, it is argued that the current regime on subsidies in the AfCFTA prevents this by prohibiting local content and export subsidies, even where their effects would be to stimulate competition within the market.

Moreover, it is argued that in some cases, other kinds of subsidies may have the same effect on the market as prohibited subsidies.[84] For instance, a government may be trying to protect an infant industry that produces electric vehicles using local instead of domestic content. The government could grant subsidies to firms operating in the electric vehicle industry if they meet the local content requirements set by the government. Alternatively, the government may offer to subsidise consumers of the electric vehicles by paying part of the purchaser's costs if the purchaser buys a vehicle produced using local content.

In the first scenario, the government measure constitutes a prohibited subsidy because it is contingent on the use of local over imported content. In the second scenario, the subsidy may

[80] *Ibid.*
[81] Appellate Body Report, *Brazil – Export Financing Programme for Aircraft* (2 August 1999) WT/DS46/AB/R para 4.
[82] *Ibid.*
[83] Lee 2006 *North Carolina Journal of International Law and Commercial Regulation* 151.
[84] S Lester "The Problem of Subsidies as a Means of Protectionism: Lessons from the WTO *EC – Aircraft* Case" (2011) 12 *Melbourne Journal of International Law* 1 at 11.

not even trigger the operation of the Guidelines because it is granted to a consumer and not to a specific firm or industry. However, both subsidies in this case both achieve the same result, albeit in different ways. The producer subsidy increases the supply of the product in the market, while the consumer subsidy increases the demand for the product.[85] Both subsidies have an effect on the protection of the industry and on the ability of foreign firms to enter into the domestic market.[86]

Two observations can be made from this. First, the subsidies regime is ineffective in regulating the anti-competitive effects of subsidies insofar as they do not allow for the examination of the subsidy's effects in the market. Secondly, the fact that it is possible to use other kinds of subsidies to mimic the effects of prohibited subsidies in the market is one of the reasons that the current scheme of regulation is ineffective in regulating prohibited subsidies.

3.4 Conclusion

In some instances, subsidies not only serve to correct market failures, but they can stimulate competition in the market by facilitating the entry of new competitors therein. This is seen in industries such as the aircraft industry, where there are financial barriers to entry that cannot be overcome without some form of subsidisation. The effect of an absolute prohibition on export and local content subsidies may be to stifle competition in industries that might otherwise have prospered from the entrance of new competitors.

Furthermore, the provisions on general exceptions and trade remedies do not provide much clarity on how prohibited subsidies will be regulated. Not only do these provisions create uncertainty as to what conduct is expected from member states, but their application may also lead to inconsistencies in the application of the Protocol on Goods in its entirety. Ultimately, it is argued that the AfCFTA Guidelines do not regulate the anti-competitive effects of prohibited subsidies effectively.

[85] *Ibid.*
[86] *Ibid.*

Chapter 4: Subsidies in the World Trade Organisation

4.1 Introduction

This chapter analyses the regulation of subsidies in the WTO and the ongoing debate about whether the GATT may be used to justify subsidies which are inconsistent with the SCM Agreement. In the previous chapter, it was concluded that the use of prohibited subsidies in the AfCFTA is regulated ineffectively. Therefore, the goal of this chapter is to determine whether resolving this debate may help to address the gaps in the regulation of prohibited subsidies in the AfCFTA. The first section gives an overview of the SCM Agreement.[1] The section discusses the definitional elements of a subsidy, specifically expanding on the different types of financial contribution articulated in the SCM Agreement.

To avoid repetition, the analysis of a benefit and specificity are not discussed in this chapter because they have already been discussed in the previous chapter and apply here *mutatis mutandis*. The second section of this chapter discusses the difference between prohibited and actionable subsidies in the SCM Agreement. Specifically, the section discusses the difference between *de jure* and *de facto* contingency and the importance of this difference in determining whether a subsidy is prohibited. Finally, the section discusses the remedies that are available to a complainant state once it is established that a subsidy is a prohibited subsidy.

The third section involves a discussion of the debate surrounding the application of the GATT to justify subsidies which are inconsistent with the provisions of the SCM Agreement. The final section of the chapter is a discussion of how the principles developed in the previous section can be applied in the AfCFTA. Specifically, this section discusses how purposive legal interpretation may fill the gaps in the regulation of subsidies in the AfCFTA that are highlighted in the previous chapter.

4.2 The definition of a subsidy

4.2.1 Financial Contribution

[1] Unless as otherwise provided, all references to Articles in this chapter are references to Articles of the SCM Agreement.

The determination of a financial contribution in the SCM Agreement covers instances where a government or public body acts directly by providing, *inter alia,* a direct transfer of funds or foregoing revenue that is otherwise due. It also provides for situations in which a government provides or purchases goods, or offers a financial contribution indirectly through a private body.[2] Where the payment is actually attributable to a private body, it cannot constitute a financial contribution because there is no involvement of a government or a public body.[3] Each of these forms of financial contribution is discussed below.

4.2.1.1 Direct transfer of funds

According to the WTO Appellate Body, the term "funds" refers not only to money, "... but also financial resources and other financial claims more generally".[4] Furthermore, Article 1.1(a)(1)(i) of the SCM Agreement mentions grants, loans and equity infusions as examples of direct transfers of funds to highlight that "funds" does not only refer to money. Article 1.1(a)(1)(i) aims to cover government measures that increase the financial capabilities of a recipient in a manner that is similar to the examples listed therein.[5]

Article 1.1(a)(1)(i) includes in its ambit the transfer of liabilities. Such a transfer may include debt forgiveness, which extinguishes a creditor's claim, the result being that a borrower is assumed to have repaid the loan advanced to it.[6] Alternatively, it may be in the form of an extension of a loan's maturity, which allows the borrower to pay the loan back over an extended period. This measure lowers the burden that the borrower has to service the debt.[7] In both these cases, there is a direct transfer of funds because the recipient receives financial resources that improve its financial position.[8] Therefore, the scope of Article 1.1(a)(1)(i) is wide enough to allow for both the transfer of money and other types of transfer of funds.

4.2.1.2 Government revenue that is otherwise due is foregone or not collected

[2] M Matsushita *et al World Trade Organisation: Law, Practice and Policy* 3ed (2015) 306.
[3] *Ibid.*
[4] Appellate Body Report, *Japan – Countervailing Duties on Dynamic Random Access Memories From Korea* (28 November 2007) WT/DS336/AB/R para 250.
[5] Matsushita *et al World Trade Organisation* 307. These examples include grants, loans, loan guarantees and equity infusions.
[6] *Ibid.*
[7] *Ibid.*
[8] *Ibid.*

The word "foregone" implies that the government has relinquished its entitlement to raise revenue that it otherwise could have raised.[9] When a government 'foregoes' revenue that is 'otherwise due', it raises less revenue than it would have raised under normal circumstances.[10] An excellent example of revenue that is foregone by a government is the granting of complete or partial tax exemptions in EPZs or the non-enforcement of tax laws for struggling or newly-established enterprises. The measure in question cannot be assessed in the abstract, as there should be a benchmark that forms the basis of a conclusion that government revenue has been foregone.[11]

The term "otherwise due" suggests that the revenues due under the measure that is challenged must be compared to revenues that would otherwise be due in any other situation.[12] The rules applied by the respondent state must be the basis of the comparison.[13] The *US – FSC,*[14] dispute is an example of this. The US' tax laws allow it to tax all income earned worldwide by its citizens and residents.[15] A corporation is deemed to be domestic and resident in the US if it is incorporated under one of the fifty states or the District of Colombia.[16] Conversely, a corporation not incorporated in any of the 50 states or the District of Colombia, is referred to as a 'foreign' corporation.[17]

Income earned by foreign corporations outside the US is not subject to income tax because it is not connected to the US. However, income earned by a foreign corporation is subject to tax in the US where it is effectively connected to the operation of a trade or a business within the US.[18] For instance, this could be the case when the foreign corporation is a subsidiary of a corporation that is resident in the US. In such a case, when the parent company earns income from the subsidiary in the form of a dividend, such an income would be subject to taxation.[19]

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[9] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* (24 February 2000) WT/DS108/AB/R para 90.
[10] *Ibid.*
[11] *Ibid.* As the Appellate Body noted in its report, the benchmark used in such an instance would be the respondent nation's tax laws, as this helps establish whether there has been revenue that has been foregone.
[12] *Ibid.*
[13] *Ibid.*
[14] n 8 above. A Foreign Sales Corporation (FSC) is a foreign corporation established to deal with sales-related activities connected with selling or leasing goods that are produced in the US for export in foreign markets.
[15] ABR, *US – FSC* para 6.
[16] *Ibid.*
[17] *Ibid.*
[18] ABR, *US – FSC* para 7.
[19] ABR, *US – FSC* para 8.

The FSC measure in question exempted a portion of the income generated by an FSC from taxation even where it was effectively connected to trade or business in the US. As a result, the enquiry involved a comparison of the FSC measure that excluded certain income from taxation and other rules of taxation that applied in the US. Without the FSC measure, the income that had been exempted would have been subject to ordinary taxation rules that applied to FSCs whose business or trade was effectively connected to the US.[20] Therefore, the Appellate Body concluded that the FSC measure resulted in the US government foregoing revenue that was otherwise due under Article 1.1(a)(1)(ii) of the SCM Agreement.[21]

4.2.1.3 The provision of goods or services other than general infrastructure, or the purchase of goods.

General infrastructure refers to infrastructure that is made available to all or nearly all entities, and is not restricted to a single entity or a group of entities within a WTO member's territory.[22] When considering whether infrastructure is general, one of the factors considered is the presence of any limitations, *de jure* or *de facto*, that restrict access to such infrastructure to a single or a few entities.[23] Although this is an important consideration, it is not the only one that is legally relevant or decisive in a Panel's inquiry.[24]

Article 1.1(a)(1)(iii) of the SCM Agreement covers two types of transactions. First, it provides for situations where the government provides goods or services other than general infrastructure. Such actions result in the cost of manufacturing products being artificially lowered by a government that provides goods which have a financial value to enterprises.[25] The result is that the cost of production decreases because the government provides the goods in question and not because of an enterprise's efficiency. Therefore, the provision of goods by the government constitutes a financial contribution.

Notably, Article 1.1(a)(1)(iii) does not specify whether the goods or services must be provided gratuitously or in exchange for money or other goods or services. The provision covers both situations where goods or services are provided gratuitously by a government and

[20] Matsushita *et al World Trade Organisation* 309.
[21] ABR, *US – FSC* para 95.
[22] Panel Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft* (30 June 2010) WT/DS316/R para 7.1036.
[23] PR, *EC – Large Civil Aircraft* para 7.1037.
[24] *Ibid.*
[25] Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada* (19 January 2004) WT/D257/AB/R para 53.

where some form of payment is required in exchange.[26] Therefore, this provision captures a government's provision of goods or services regardless of whether the recipient is required to make payment to the government.[27] Ultimately, the provision also covers situations where the government may require payment for the provision of goods and services, but where such payment is below the value of the goods or services in question.

Second, the provision contemplates transactions where a government purchases goods from an enterprise. This type of transaction artificially increases the revenues earned by a company from selling a particular product.[28] For instance, this would be the case where a government implements a scheme through which it purchases a certain percentage of the goods produced by a specific enterprise or industry within its territory. The increase in revenue is artificial because, without the government's intervention, the revenue generated by the enterprise or industry in question would be lower.

These two types of transactions can be distinguished based on three aspects. First, the goods, in this case, are provided to the government, and not by it.[29] Second, the use of the word "purchase" in relation to the second transaction specifies that the goods in question are provided for some form of consideration in return.[30] Finally, the second transaction only covers goods, while the first transaction covers both goods and services.[31] Ultimately, both transactions target the WTO-inconsistent manipulation of the competitive relationships between enterprises which receive a benefit from state aid, and those that do not benefit from such aid.[32]

4.2.1.4 Providing a financial contribution through a private entity

Article 1.1(a)(1)(iv) of the SCM Agreement covers instances where a government makes a payment to a funding mechanism, or where it uses a private entity as an intermediary to make a financial contribution to an enterprise or industry. Where a private intermediary is involved, the determination of whether there is a financial contribution depends on whether the actions of the entity can be attributed to the state. The conduct of a person or entity that is not an organ of state may be attributed to the state when the state empowers such a person or entity

[26] ABR, *US – Large Civil Aircraft* (Second Complaint) para 618.
[27] *Ibid.*
[28] ABR, US – Softwood Lumber IV para 53.
[29] ABR, *US – Large Civil Aircraft* (Second Complaint) para 619.
[30] *Ibid.*
[31] *Ibid.*
[32] Matsushita *et al World Trade Organisation* 311.

in question.[33] Therefore, a state incurs responsibility when, acting through its agent, it violates the provisions of a treaty which binds it.[34]

The SCM Agreement specifies that the conduct of a private entity is attributable to the state where the actions of the entity were entrusted or directed by the state. A private entity is said to be "entrusted" when a government gives it responsibility.[35] On the other hand, a private entity is considered to be "directed" when the government exercises authority over it.[36] In both cases, the government uses a private entity as an intermediary to implement one of the financial contributions listed above.[37] Although it may be challenging to determine when there has been entrustment or direction, the presence of some form of threat or inducement by the government may serve as evidence of this.[38]

4.3 Actionable and prohibited subsidies.

4.3.1 Actionable Subsidies

Article 5 of the SCM Agreement prohibits states from causing adverse effects to the interests of other members by (i) injuring their domestic industry; (ii) nullifying or impairing benefits accruing directly or indirectly to other members under Article II of the GATT; or (iii) causing serious prejudice thereto.[39]

Article 5 indicates that other than the subsidies expressly prohibited by Article 3, the SCM Agreement is concerned with the causing of harm to other members of the WTO through the use of subsidies.[40] Two points further illustrate this. First, the analysis of whether a subsidy exists focuses on the existence of a benefit that leaves a recipient better off in relation to their competitors, and not in the abstract, which means that competitive benefits are the focus of

[33] Article 8 of the Draft Articles on the Responsibility of States for Internationally Wrongful Acts, November 2001, Supplement No. 10 (A/56/10), chp.IV.E.1; Matsushita *et al World Trade Organisation* 313; J Dugard *International Law: A South African Perspective* 4ed (2011) 271.
[34] Dugard *International Law* 270.
[35] Appellate Body Report, *United States – Countervailing Duty Investment on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea* (27 June 2005) WT/DS296/AB/R para 116.
[36] *Ibid.*
[37] *Ibid.*
[38] *Ibid.* in para 114, the Appellate Body held that entrust or direction by a government cannot be inadvertent or an incidence of government regulation. This means that such entrustment or direction must be the result of an exercise of government authority beyond its regulatory scope.
[39] Footnote 13 of the SCM Agreement states that the phrase "serious prejudice" also includes the threat of serious prejudice.
[40] Matsushita *et al World Trade Organisation* 337.

the analysis.[41] Second, Article 5 makes subsidies actionable based on their adverse effects,[42] which means that the competitive benefits conferred by the financial contribution must adversely affect another WTO member.

The adverse effects referred to in Article 5 may come about in three ways. First, an adverse effect occurs when a domestic industry that engages in direct competition with subsidised producers of like products suffers an injury,[43] that is attributable to the subsidy granted.[44] Article 15.1 of the SCM Agreement states that the determination of injury shall be based on an objective examination of (a) the volume of subsidised imports and the effect of such imports on prices in the domestic market for like products and (b) the consequent impact of these imports on domestic producers of such products.

The injury follows from the impact of a subsidy on the price of products and, in turn, on domestic producers. This is because better pricing increases an enterprise's market share, which improves its competitiveness. Such an improvement is unfair because it is the result of subsidisation and not market forces.[45] According to Article 15.2 of the SCM Agreement, to determine the effect of a subsidy on prices, investigating authorities must consider whether there is: (1) significant price undercutting as a result of the subsidised import, (2) significant price depression, or (3) significant prevention of price increases, which would have otherwise occurred.

Second, a subsidy may cause adverse effects when it results in the nullification of benefits accruing directly or indirectly to other members of the WTO under the GATT 1994. Nullification or impairment is used in the same it is used in the other provisions of the GATT.[46] Nullification or impairment which results from the violation of a provision and nullification or impairment that is specifically caused by the use of a subsidy are distinguishable. A complainant must show that the nullification or impairment is a result of

[41] L Rubini "Ain't Wastin' Time No More: Subsidies for Renewable Energy, the SCM Agreement, Policy Space, and Law Reform" (2012) 15 *Journal of Economic Law* 525 at 549.
[42] AO Sykes "The Questionable Case for Subsidies Regulation: A Comparative Perspective" (2010) 2 *Journal of Legal Analysis* 473 at 482.
[43] Footnote 11 of the SCM Agreement states that the term "injury" is used in Article 5 as it is used in Part V of the Agreement. Particularly, Article 15.2 of the SCM Agreement plays a significant role in determining whether there has been an injury to a domestic industry.
[44] Matsushita *et al World Trade Organisation* 338.
[45] Matsushita *et al World Trade Organisation* 339.
[46] Footnote 12 of the SCM Agreement.

the use of a subsidy and not a direct violation of another provision in the GATT.[47] This is because assuming that the violation of a provision of the GATT constitutes nullification or impairment would eliminate the distinction between prohibited subsidies and subsidies that cause adverse effects.[48] Therefore, nullification or impairment is presumed where the use of a subsidy violates a GATT provision.[49]

Finally, a subsidy causes an adverse effect when it results in serious prejudice to the interests of another member. The SCM Agreement states that "serious prejudice to the interests of another member is used in the same sense as it is used in Article XVI of the GATT and includes threat of serious prejudice.[50] Article 6.3 further states that:

> "Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:
>
> a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;
>
> b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market;[51]
>
> c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;[52]
>
> d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years, and this increase follows a consistent trend over a period when subsidies have been granted."

The language of Article 6.3 indicates that what constitutes serious prejudice to the interests of another member depends on the effect of the measure in the relevant

[47] Panel Report, *United States – Continued Dumping and Subsidy Offset Act of 2000* (16 September 2002) WT/DS217/R/ WT/DS234/R para 7.119.
[48] *Ibid.*
[49] PR, *US – Offset Act* para 7.120.
[50] Footnote 13 of the SCM Agreement.
[51] This provision is interpreted in Article 6.4.
[52] This provision is interpreted in Article 6.5.

market.[53] Paragraphs (a) and (b) require that the effect of a measure be analysed in markets in the subsidising member and a third country, respectively, effectively confining the relevant market to a particular geographic area.[54] Arguably, paragraphs (a) and (b) seek to determine whether subsidisation hinders competition in the subsidising state and a third country.

Paragraph (a) contemplates a situation in which subsidisation results in the protection of the domestic industries of the subsidised enterprises by making imported products less attractive because of lower domestic prices.[55] Paragraph (b) deals with a situation where subsidisation makes it difficult, if not impossible, for WTO members to compete with the subsidising member for market shares in third countries.[56] Therefore, the definition of the relevant market provides the basis upon which to determine whether a member's imports or exports have been displaced or impeded by the subsidised product.

Displacement occurs when the sales of the subsidised product replace the imports or export of a like product.[57] It is a result of competition between products in the market and specifically arises because subsidisation allows enterprises to price their products to replace their competitors' products.[58] An import or export of a like product is impeded where it would have expanded if it had not been obstructed or hindered by the subsidised product.[59] An impediment may also occur where a member cannot import or export a like product at all because the subsidised product hindered the production of such a product.[60]

In contrast, paragraph (c) contains no such limitation and instead requires that a measure must be implemented in the 'same market'. Paragraph (c) does not limit the analysis of a measure's effect to a particular area. It is possible for products to compete in the same market even if they are not sold in the same place and at the same

[53] Matsushita *et al World Trade Organisation* 345.
[54] ABR, *US – Upland Cotton* para 406.
[55] Matsushita *et al World Trade Organisation* 348.
[56] *Ibid.*
[57] Appellate Body Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft* (18 May 2011) WT/DS316/AB/R para 1119.
[58] *Ibid.*
[59] ABR, *EC and Certain Member States – Large Civil Aircraft* para 1161.
[60] *Ibid.*

time.[61] Whether two products compete in the same market may depend on factors that include the nature of the products and their substitutability, price, and transport costs.[62] Therefore, the 'same market' may refer to the world market for a particular product, even though the products in question do not compete in the same geographic area.[63]

Paragraph (c) involves a determination of whether there has been significant price undercutting, significant price suppression, significant price depression or lost sales in the same market. Price suppression occurs when subsidisation prevents the price of a product from increasing or where the increase is less than it would have been in the absence of a subsidy.[64] On the other hand, price depression occurs when the price of a product is reduced or pushed down because of the subsidy.[65] It is easier to determine when price depression has occurred than it is to determine whether price suppression has occurred.

Determining the existence of price suppression requires a comparison of the actual price of a product with what the price of such a product would have been had the subsidy not been granted.[66] The goal of such a comparison is to determine whether the effect of subsidisation was to prevent prices from increasing or from increasing more than they actually did.[67] Therefore, a complainant state must establish a causal link between the subsidy and the effect thereof in the market.[68] The use of the word "effect" instead of "cause" means that the analysis of a causal link focuses on the effects resulting from a chain of causation and not factors that trigger a specific event.[69]

'Lost sales', which are covered in the scope of paragraph (c) refers to sales that a supplier was unable to secure as a result of the subsidy.[70] The concept of lost sales includes a consideration of the position of the subsidised product and the product of a

[61] ABR, *US – Upland Cotton* para 408.
[62] *Ibid.*
[63] *Ibid.*
[64] Appellate Body Report, *United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)* (12 March 2012) WT/DS353/AB/R para 1091.
[65] *Ibid.*
[66] Appellate Body Report, *United States – Subsidies on Upland Cotton* (Recourse to Article 21.5 of the DSU by Brazil) (2 June 2008) WT/DS267/AB/RW para 351.
[67] *Ibid.*
[68] ABR, *US – Upland Cotton* (Article 21.5) para 372.
[69] *Ibid.*
[70] ABR, *EC and Certain Member States – Large Civil Aircraft* para 1214.

complaining member.[71] The loss of sales to the complaining member must have occurred because of the impugned subsidy.[72] In addition to requiring a causal link between the subsidy in question and the price suppression, price depression and lost sales, paragraph (c) further qualifies all three concepts by requiring a member to prove their significance.[73] Therefore, the effects must be more consequential and important than just a dent to the commercial expectations of an enterprise.[74]

4.3.2 Prohibited subsidies

According to Article 3.1:

> "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> a) subsidies contingent, in law [*de jure*] or in fact [*de facto*],[75] whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;
>
> b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods."

According to Article 3.2, "members may neither grant nor maintain subsidies referred to in paragraph 1".

The rationale behind the prohibition of export subsidies and local content subsidies in the WTO is that they represent a targeted intrusion into the domestic industries of member states that produce products similar to those that are subsidised.[76] On the one hand, export subsidies support enterprises in their competition with companies from foreign markets, which distorts trade.[77] On the other hand, local content subsidies nullify a country's market access benefits by incentivising corporations not to import

[71] *Ibid.*
[72] *Ibid.*
[73] ABR, *EC and Certain Member States – Large Civil Aircraft* para 1215; Matsushita *et al World Trade Organisation* 350.
[74] Matsushita *et al World Trade Organisation* 350.
[75] Footnote 4 of the SCM Agreement provides that this standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.
[76] Matsushita *et al World Trade Organisation* 330.
[77] *Ibid.*

from foreign producers.[78] Ultimately, both these subsidies give an unfair competitive advantage to the recipients thereof.

4.3.2.1 Export subsidies

Article 3.1(a) provides that a subsidy may be *de jure* or *de facto* contingent on export performance. A subsidy is *de jure* contingent on export performance when this contingency can be demonstrated from the words used in the legislation, regulation or other legal measures at issue.[79] The words of the provision do not expressly have to demonstrate export contingency, as this can be determined by necessary implication from the words used in the relevant measure.[80] Therefore, a subsidy is *de jure* export contingent when a measure expressly states that such is the case, or where such contingency can be implied from the words used in the relevant legal instrument.

Proving that a subsidy is *de facto* export contingent is more difficult as a relationship of contingency must be demonstrated from all the facts surrounding the granting of the subsidy, none of which will be individually decisive.[81] There is no general rule regarding what facts or what kind of facts should be taken into account when determining the existence of *de facto* contingency.[82] Determining whether there is *de facto* contingency requires that there must be a close connection between the grant of the subsidy and actual or anticipated exportation or exportation earnings of an entity.[83]

The following factors may be considered when determining whether there is *de facto* export contingency: (i) the design and structure of the legal provision granting the subsidy; (ii) the way that the legal provision is applied; and (iii) any relevant factual circumstances surrounding the granting of the subsidy that may provide context for understanding the

[78] *Ibid.*
[79] Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry* (31 May 2000) WT/DS139/AB/R/ WT/DS142/AB/R para 100.
[80] *Ibid.*
[81] ABR, *Canada – Aircraft* para 167.
[82] ABR, *Canada – Aircraft* para 169.
[83] Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather* (25 May 1999) WT/DS126/R para 9.55. In PR, *Canada – Aircraft* para 171, it was held that it does not suffice to demonstrate that the government granting a subsidy *anticipated* that exportation would result from the subsidy. A complainant bears the burden of proving that the grant of the subsidy was actually *contingent* on actual or anticipated exportation. See ABR, *EC and Certain Member States – Large Civil Aircraft* para 1045.

design, structure and application of the legal provision concerned.[84] However, these factors on their own are not decisive when determining the existence of *de facto* contingency.

Where evidence is available, a complainant can determine contingency by comparing the effects of subsidisation to what would be the case in the absence thereof. On the one hand, a panel can assess the ratio of anticipated exports and domestic sales of the subsidised product, which result from the subsidy.[85] On the other hand, a panel may analyse the same ratio in the absence of a subsidy by assessing the historical sales of the product by the recipient before the subsidy was granted.[86] Where historical sales do not exist because the product in question is new, the assessment may be done by analysing the performance that an efficient firm would be expected to achieve in the market in the absence of a subsidy.[87]

Suppose evidence shows that the subsidy incentivises a producer to export more in comparison to the situation before the subsidy was granted. In that case, this is likely to indicate that the grant of the subsidy is in fact tied to a producer's export performance.[88] Therefore, the evidence must indicate that even though the words of the legal measure do not make the granting of the subsidy contingent on export performance, the application of the measure has this effect. The test requires that the contingency between the granting of the subsidy and export performance must be objectively observable from the evidence presented.[89] Ultimately, this involves an examination of the way a measure is applied and not the provisions of the measure itself.

4.3.2.2 Local content subsidies

It is important to note that there is a distinction between domestic subsidies and subsidies contingent upon the use of domestic over imported goods. A government can subsidise goods and increase supply in the domestic market, which may adversely impact imports from other

[84] ABR, *EC and Certain Member States – Large Civil Aircraft* para 1046.
[85] ABR, *EC and Certain Member States – Large Civil Aircraft* para 1047.
[86] *Ibid.*
[87] *Ibid.*
[88] *Ibid.* It has been held that assessments based on ratios (the ratios test) is neither compulsory to perform, nor can it independently be used to determine whether there is *de facto* export contingency. This means that this test serves to supplement analysis which examines the structure, design, and application of the measure and not to replace it. See Panel Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft (Recourse to Article 21.5 of the DSU by the United States)* (22 September 2016) WT/DS316/RW paras 6.695 and 6.696.
[89] ABR, *EC and Certain Member States – Large Civil Aircraft* para 1051.

countries, without requiring the use of domestic over imported goods.[90] Subsidies are not banned solely on the basis that they support domestic production. For Article 3.1(b) to come into operation, the granting of the subsidy must be contingent on the use of domestic over imported goods.[91]

Despite the language of Article 3.1(b) not explicitly providing for this, The Appellate Body has found that it covers both *de jure* and *de facto* contingency. Two reasons exist for this. First, Article III:4 of the GATT 1994, which deals with National Treatment,[92] addresses measures that favour domestic goods over imported goods and covers *de jure* and *de facto* inconsistency.[93] According to the Appellate Body, it would be surprising if a similar rule that dealt with measures that favour domestic production over imports, did not apply to *de facto* inconsistency, albeit in a different context.[94]

Second, relying on reasoning it employed in a previous decision,[95] the Appellate Body held that the fact that Article 3.1(a) explicitly referred to *de jure* and *de facto* export contingency did not mean that Article 3.1(b) only extended to *de jure* contingency.[96] If the provision allowed only for *de jure* contingency, WTO members would find it easy to circumvent Article 3.1(b).[97] This is because member states would be able to apply the provision in a manner in which the granting of the subsidy is contingent on the use of domestic over imported goods. This would be contrary to the object and purpose of the SCM Agreement.[98]

The analysis undertaken to determine *de jure* and *de facto* contingency under Article 3.1(a) is relevant to the determination of contingency under Article 3.1(b).[99] Notably, Article 3.1(b) does not require that domestic goods must displace a particular amount or level of imported

[90] Appellate Body Report, *United States – Conditional Tax Incentives for Large Civil Aircraft* (4 September 2017) WT/DS487/AB/R para 5.15.
[91] *Ibid.*
[92] The principle of National Treatment requires that tariffs, regulations, and other measures affecting the sale or transportation of products must not be applied in a manner that protects domestic production. See Article III:1 of the GATT.
[93] ABR, *Canada – Autos* para 140.
[94] *Ibid.*
[95] See Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas* (25 September 1997) WT/DS27/AB/R para 233.
[96] ABR, *Canada – Autos* para 141.
[97] ABR, *Canada – Autos* para 142.
[98] *Ibid.*
[99] ABR, *US – Tax Incentives* para 5.12.

goods.[100] This means that the application of this measure is not limited to cases in which a producer is required to use domestic goods to the complete exclusion of imported goods.[101]

The question is whether a condition that requires the use of domestic over imported goods can be discerned either from the terms of the legal instruments or from the circumstances surrounding its application.[102] Arguably, the focus is on discerning the presence of a condition requiring the use of domestic over imported goods, and not on whether the requirements for receiving a subsidy may result in the use of domestic over imported goods.[103] Therefore, a complainant succeeds in its claim when it can demonstrate that the use of domestic over imported goods is a condition for the grant of a subsidy, even if there has not been a displacement of imported goods by domestic goods.

4.4 Remedies

4.4.1 Remedies against members that use prohibited subsidies

Article 4 sets out the remedies available to a complainant that raises a claim of prohibited subsidies. According to Article 4.1, a complainant may request consultations with a member of the WTO that is believed to be granting or maintaining a prohibited subsidy.[104] The request must include all the available evidence concerning the existence and the nature of the subsidy in question.[105] If the dispute cannot be resolved through the consultation, it may be referred to the WTO's dispute settlement panel, and then to the Appellate Body, for adjudication.[106]

According to Article 4.7, if a subsidy is found by the WTO's Dispute Settlement Body (DSB) to be prohibited, the government using the subsidy will be required to withdraw the subsidy immediately.[107] This provision is a deviation from the usual procedure of the Dispute Settlement Understanding (DSU), which requires a subsidy to be withdrawn within 'a

[100] ABR, *US – Tax Incentives* para 5.22.
[101] *Ibid.*
[102] Appellate Body Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft* (Recourse to Article 21.5 of the DSU by the United States) (15 May 2018) WT/DS316/AB/RW para 5.63.
[103] *Ibid.*
[104] Article 4.1 of the SCM Agreement.
[105] P Van den Bossche and W Zdouc *The Law and Policy of the World Trade Organization: Text, Cases and Materials 4ed* (2017) 808.
[106] *Ibid.*
[107] NC Rotich *Assessing Kenya's Free Zones Consistency with WTO Agreements on Subsidies and Countervailing Measures and Agriculture* (LLM Thesis, University of Pretoria, 2019) 31. Article 4.7 further states that the panel shall specify in its recommendation the time-period within which the measure must be withdrawn.

reasonable period of time'.[108] The recommendation made under this Article remains in effect until the member concerned has fully withdrawn the prohibited subsidy.[109] If a member withdraws the subsidy partially, the obligation remains for the part of the subsidy which has not been withdrawn.[110] Therefore, the member is under an obligation to withdraw the subsidy entirely.

According to Article 4.10, should the respondent government fail to withdraw the subsidy, the Dispute Settlement Body will authorise the complainant to take appropriate countermeasures.[111] The term 'appropriate measures' deviates from the language of the DSU. Article 22.4 of the DSU uses the term 'equivalent' to describe the relationship between the damage suffered by a country and the extent of the countervailing measure it uses to force the respondent country to withdraw its measure.[112] However, the SCM Agreement clarifies that this is not "... meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited".[113]

The deviation from Article 22.4 of the DSU emanates from the purpose of Article 4, which is to achieve the withdrawal of a prohibited subsidy as compared to the removal of a specific nullification or impairment caused to a WTO member by any other measure.[114] Therefore, the former remedy aims to remove a measure that is presumed to distort trade, regardless of which WTO member suffers the adverse effects and the extent thereof.[115] The latter remedy targets the adverse effects of a measure on the trade of a specific WTO member.[116] Therefore, the different aims pursued by Article 4 of the SCM Agreement necessitate a deviation from the usual standard enshrined in the DSU.

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[108] Article 21.3 of the WTO Understanding on the Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401.
[109] Appellate Body Report, *United States – Tax Treatment for "foreign Sales Corporations" (Second Recourse to Article 21.5 of the DSU by the European Communities*) (13 February 2006) WT/DS108/AB/RW2 para 83.
[110] *Ibid.*
[111] *Ibid.* Article 4.10 further provides that such authorisation will be granted unless the Dispute Settlement Body rejects such a request for authorisation by consensus.
[112] Matsushita *et al World Trade Organisation* 355. Article 22.4 of the DSU states that "the level of the suspension of concessions and other obligations authorised by the DSB shall be equivalent to the level of nullification or impairment.
[113] Footnote 9 of the SCM Agreement.
[114] Decision by the Arbitrators, *Brazil – Export Financing Programme for Aircraft (Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)* (28 August 2000) WT/DS46/ARB para 3.48.
[115] *Ibid.*
[116] *Ibid.*

In keeping with the reasoning that Article 4 targets prohibited subsidies, the Arbitrator's report on the *US – FSC* dispute,[117] stated that complainants should be allowed to adopt countermeasures up to an amount similar to the amount of the subsidy paid.[118] In the case of prohibited subsidies, adjudicating bodies use the amount of a subsidy as a reference, rather than the trade effects thereof. The reason behind this is that in the case of prohibited subsidies, it is the subsidisation itself that nullifies the rights and benefits of other WTO members and not the harmful effects of the subsidy.[119] Therefore, the violation rests on the mere institution of the subsidy, regardless of its effect in the relevant market.

4.4.2 Special and differential treatment in the SCM Agreement

Special and differential treatment refers to provisions in WTO agreements that allow developing and least developed countries to receive more favourable treatment where their development constrains their ability to honour their WTO commitments.[120] Essentially, special and differential treatment acknowledges that developing countries face constraints that affect their ability to participate in international trade on the same level as developed countries.[121] Special and differential provisions can be divided into measures that allow for less stringent obligations, grant a more flexible timeline for implementing measures and rulings, or treat least developed countries more favourably.[122]

The SCM Agreement contains special and differential provisions that provide thresholds that must be met for countries implementing countervailing measures against developing countries, unique timeframes for implementation, and rules on the use of export subsidies by developing countries.[123] Article 27.1 provides that "members recognise that subsidies may play an important role in the economic development programmes of developing countries".[124] Furthermore, Article 27.2(a) provides that the prohibition on export subsidies does not apply to WTO members designated as least developed countries by the United Nations as well as

[117] See note 13 above.
[118] Decision of the Arbitrators, *United States – Tax Treatment for "Foreign Sales Corporations" (Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement)* (30 August 2002) WT/DS108/ARB para 6.31.
[119] Matsushita *et al World Trade Organisation* 357.
[120] AM Brennan "The Special and Differential Treatment Mechanism in the WTO: Cultivating Trade Inequality for Developing Countries?" (2011) 14 *Trinity College Law Review* 143 at 144.
[121] Brennan 2011 Trinity College Law Review 147.
[122] A Jayagovind "Special and Differential Treatment in International Trade: A Developing Country Perspective" (2008) 20 *National Law School of India Review* 95 at 101.
[123] Jayagovind 2008 *National Law School of India Review* 102.
[124] Article 27.1 of the SCM Agreement.

developing countries that are WTO members with a GNP per capita of less than one thousand US dollars per annum (Annex VII Countries).[125]

To prevent problems related to fluctuations in developing countries' growth, the threshold of US$1,000 must be in constant 1990 dollars and should be reached for three consecutive years.[126] Furthermore, countries can be re-included in the list when their GNP per capita falls below the threshold again.[127] This threshold only applies to Annex VII countries, which means countries that fall below the threshold but are not listed cannot benefit from this provision.[128] Consequently, countries which fall below this threshold and use export subsidies may still face challenges that may result in them having to withdraw their subsidy programmes.

It must be noted that the exemption for developing countries is not absolute; two caveats apply in this regard. First, Article 27.5 provides that developing countries are required to phase out their export subsidies when they have "reached export competitiveness in any given product".[129] According to Article 27.6, "export competitiveness in a product exists if a developing country member's exports of that product have reached a share of at least 3.25 per cent for two consecutive years".[130] This provision ensures that subsidies are phased out when they are no longer needed to pursue development objectives and that they do not result in a country's ability to affect world prices and hurt foreign producers.[131]

Second, Article 4 provides that a measure must be withdrawn if it constitutes a prohibited subsidy and allows a complainant to use countermeasures where the subsidy is not withdrawn. Article 27.7 provides that these remedies do not apply to Annex VII countries.[132] However, this section also provides that export subsidies by Annex VII countries can be

[125] Paragraph (b) of Annex VII to the SCM Agreement lists Bolivia, Cameroon, Congo, Côte d'Ivoire, Dominican Republic, Egypt, Ghana, Guatemala, Guyana, India, Indonesia, Kenya, Morocco, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka and Zimbabwe as the only developing countries with a GNP per capita of under US$1,000 that are exempted from the prohibition on export subsidies. This is why these countries are referred to as Annex VII countries.

[126] D Coppens "How Special is the Special and Differential Treatment Under the SCM Agreement – A Legal and Normative Analysis of WTO Subsidy Disciplines on Developing Countries" (2013) 12 *World Trade Review* 79 at 83.

[127] *Ibid.*

[128] *Ibid.*

[129] Article 27.5 of the SCM Agreement.

[130] Article 27.6 of the SCM Agreement.

[131] Coppens *Disciplines on Subsidies* 568.

[132] The countries listed in Annex VII are Bolivia, Cameroon, Congo, Côte d'Ivoire, Dominican Republic, Egypt, Ghana, Guatemala, Guyana, India, Indonesia, Kenya, Morocco, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka, and Zimbabwe.

challenged as actionable subsidies and be subjected to countervailing measures. This provision ensures that developing countries are held accountable without affected members subjecting them to subsidy wars.[133] The provision also ensures that developing countries do not abuse the exceptions by using subsidies that are not intended to correct market failures.[134]

Therefore, the provisions of the SCM Agreement not only recognise the need for developing countries to use subsidies to improve their development, but they provide the policy space for them to do so through special and differential treatment. Furthermore, the agreement attempts to curtail the distortive effects of export subsidies by curtailing the extent to which developing countries can use the exceptions in Article 27. However, the fact that not every developing state can use the exception signifies a loophole in subsidy laws that may be a problem for AfCFTA member states that may use subsidies to aid their development.

4.5 The relevance of the WTO's special and differential provisions in the AfCFTA

Government subsidies constitute non-tariff barriers to trade. A non-tariff barrier is a restriction on international trade that results from prohibitions, regulations, conditions, and any other measures other than tariffs.[135] Accordingly, Annex 5 to the Protocol on Goods on Non-Tariff Barriers (Annex 5) provides for the identification of non-tariff barriers. Article 2 of this annex provides that:

> "Without Prejudice to the rights and obligations under the World Trade Organisation (WTO) Agreements, this Annex provides for a mechanism for the identification, categorisation, and elimination of non-tariff barriers within the Continental Free Trade Area (AfCFTA)."

This Article serves to preserve the rights and obligations that AfCFTA members have under the WTO's SCM Agreement. This includes the rights in Article 27 relating to the use of export subsidies by developing countries. Therefore, countries in the AfCFTA may be able to refer to Article 27 of the SCM Agreement to justify their use of export subsidies.

[133] Coppens *Disciplines on Subsidies* 568,
[134] *Ibid.*
[135] E Tarver "What is a Non-Tariff Barrier?" https://www.investopedia.com/terms/n/nontariff-barrier.asp (Accessed 12 June 2020).

For least developed countries and other Annex VII countries in the AfCFTA, Article 27 of the SCM Agreement can be used to defend their export subsidy programmes in the WTO. However, several problems arise in the context of the AfCFTA. First, the provisions of Annex VII to the SCM Agreement refer to least developed countries and other developing countries that are members of the WTO. This means that even if a country were classified as a least developed country by the United Nations, it would not qualify for the special protections in Article 27 of the SCM Agreement if it was not a member of the WTO.

The AfCFTA currently has signatories who are not full members of the WTO. Countries such as Sudan, Somalia, South Sudan, and Ethiopia only have observer status in the WTO, which means that they do not have any rights under the various WTO agreements, including the SCM Agreement.[136] Consequently, they will not be able to use export subsidies in the AfCFTA. This is because if any of these countries implemented a subsidy programme which was found to constitute prohibited subsidisation according to the Guidelines, it would have to withdraw the measure.

The provisions of the SCM Agreement, together with the AfCFTA Agreement's lack of provisions that allow countries to justify their export subsidy programmes means that AfCFTA members will be unable to utilise export subsidies as a policy tool to enhance their industrialisation. Moreover, the exemption in Article 27 of the SCM Agreement does not apply to members of the AfCFTA whose GNP per capita falls below the threshold of US$1,000 unless they are listed in Annex VII.[137] Therefore, for a country such as Cameroon, which is a WTO member and whose GNP per capita falls below this threshold, it will not be possible to use the exception because it is not listed in Annex VII.

The AfCFTA Agreement, as it stands, creates a distinction between members of the AfCFTA. On the one hand, there are members of the AfCFTA that are also members of the WTO and can invoke Article 27 of the SCM Agreement to justify their use of prohibited subsidies when challenged. On the other hand, there are members of the AfCFTA that are either not members of the WTO or are members but do not qualify to use the exceptions because they are not

[136] *World Trade Organisation* "The Accession Process – the procedures and how they have been applied" https://www.wto.org/english/thewto_e/acc_e/cbt_course_e/c4s2p1_e.htm#:~:text=Observer%20status%20in%20the%20General,Budget%2C%20Finance%20and%20Administration). (Accessed 12 June 2020).
[137] Coppens 2013 *World Trade Review* 83.

listed in Annex VII. This distinction has far-reaching effects for AfCFTA members, especially those that maintain EPZs, which are commonly used by AfCFTA member states.

4.4.4 The implications of AfCFTA regulations for EPZs

The distinction that the AfCFTA Agreement makes between different member states based on whether they are WTO members or whether they meet the conditions for special and differential treatment creates inconsistencies in the application of the AfCFTA Agreement. The result is that the provisions in the Guidelines on prohibited subsidies apply unequally to different states in the AfCFTA. This is important because EPZs are a vital policy tool for AfCFTA members that aim to attract FDI and boost their industrial development because of the ability of fiscal incentives to attract new businesses into a country.[138]

In the case of EPZs in Kenya and Malawi, which are discussed in chapter 3 above, both countries can justify their use of export subsidies by invoking their rights in terms of Article 27.2 (a) of the SCM Agreement when their subsidies are challenged in the AfCFTA. On the one hand, Kenya is listed in Annex VII as one of the developing countries exempted from the prohibition on export subsidies because its GNP per capita falls below the threshold.[139] Therefore, Kenya's EPZs are consistent with the AfCFTA Guidelines because Annex 5 allows Kenya to invoke its WTO rights in Article 27 of the SCM Agreement.

On the other hand, Malawi is classified as a least developed country by the UN. Consequently, Malawi's EPZs are exempted from the Guidelines because Malawi is a least developed country and its WTO rights to use subsidies as a least developed country are preserved in the AfCFTA by Annex 5. As a result, Annex 5 allows Kenya and Malawi to retain their rights under Article 27 of the SCM Agreement. Therefore, the fiscal incentives offered by Kenya and Malawi's governments in their EPZs cannot be challenged as prohibited subsidies in the AfCFTA.

EPZs are a notable example in this study for two reasons. First, they represent the most explicit use of prohibited subsidies to boost a country's industrial development. EPZs allow countries to develop mechanisms to stimulate investment into a country and increase

[138] C Ntagungira "The role of Togo's export processing zone in the global value chain" https://www.howwemadeitinafrica.com/the-role-of-togos-export-processing-zone-in-the-global-value-chain/42676/ (Accessed 12 June 2020).
[139] Rotich *Assessing Kenya's Free Trade Zones* 32.

efficiency in the market, which can be emulated throughout the rest of the country.[140] Ideally, stimulating investments into EPZs allows countries to develop capacities and habits that eventually spill over into the rest of the country. For this to happen, governments must be able to use subsidisation as a policy tool.

Second, EPZs are expected to be one of the many economic recovery strategies whose impact can be boosted by the operation of the AfCFTA Agreement.[141] They are expected to contribute to growth and development by helping to diversify members' exports, upgrade their industries, and facilitate broader participation in international trade.[142] However, the inconsistent application of the Guidelines concerning prohibited subsidies means that it is uncertain whether EPZs will be able to make such contributions.

Therefore, because the special and differential provisions applicable to countries using prohibited subsidies are not accessible to every AfCFTA member that needs them, they are inadequate in addressing the growing need to allow developing countries to use subsidisation as a policy tool. Furthermore, this has the effect of curtailing some developing countries' policy space, while allowing flexibility for other members to use subsidies. The problem with this distinction is that when it is applied in the AfCFTA, it is arbitrary because exemption from AfCFTA Guidelines are based on whether a member is also a member of the WTO. In this light, the AfCFTA Agreement does not regulate prohibited subsidies effectively.

Consequently, the question arises: since the AfCFTA Guidelines do not effectively regulate the use of prohibited subsidies where countries pursue legitimate policy objectives, are there principles that can be used to justify the use of such subsidies by AfCFTA member states? The WTO's regulation of prohibited subsidies has been questioned because of its lack of provision for countries wishing to use local content subsidies to address climate change concerns. Consequently, it has been suggested that Article XX of the GATT may be invoked to justify legitimate uses of prohibited subsidies in the WTO. The next section discusses this commentary and its applicability in the AfCFTA.

4.6 The applicability of Article XX of the GATT to the SCM Agreement

[140] H Stein "Africa, Industrial Policy and Export Processing Zones: Lessons from Asia" 2008 *Paper Prepared for Africa Task Force Meeting, Addis Ababa, Ethiopia* 1 at 9.
[141] L Masoga "Special Economic Zones Among the Paucity of Realistic Interventions" https://www.globalafricanetwork.com/2020/05/29/company-news/special-economic-zones-among-the-paucity-of-realistic-interventions/ (Accessed 13 June 2020).
[142] *Ibid.*

4.6.1 The development and lapse of non-actionable subsidies

Article 8 contains a third category of subsidies in addition to actionable and prohibited subsidies, referred to as non-actionable subsidies. These subsidies are referred to as 'green subsidies' because they were primarily meant to enhance sustainability and protect governments' ability to grant subsidies on legitimate grounds.[143] Article 8 was intended to exempt subsidies from the provisions of the SCM Agreement, provided that the conditions for exemption were met. Consequently, such subsidies could not be declared illegal nor subjected to countervailing measures by another WTO member.[144]

According to Article 8.1, four types of subsidies are considered non-actionable. These are (1) all subsidies that are not specific according to Article 2; (2) R&D subsidies; (3) regional subsidies; and (4) environmental subsidies. Non-specific subsidies are exempt on the basis that specificity is one of the core requirements for any subsidy complaint by a WTO member since subsidy disciplines target subsidies granted to specific firms or industries. Article 8.2 contains the rules relating to R&D subsidies, regional subsidies, and environmental subsidies.

According to Article 8.2, three categories of subsidies are non-actionable. These are:

(a) "assistance for research conducted by firms or higher education institution or research establishments on a contract basis, if the assistance does not cover more than 75 per cent of the costs of industrial research or 50 per cent of the costs of pre-competitive development activity.[145]
(b) assistance to disadvantaged regions within the territory of a Member given pursuant to a general framework of regional development,[146] and which are non-specific within the meaning of Article 2.

[143] S Charnovitz "Green Subsidies and the WTO" 2014 *World Bank Group Policy Research Paper 7060* 2 at 2; SZ Bigdeli "Resurrecting the Dead – The Expired Non-Actionable Subsidies and the Lingering Question of Green Space" (2011) 8 *Manchester Journal of International Economics* 2 at 4.
[144] Charnovitz 2014 *World Bank Group Policy Research Paper 7060* 18.
[145] Footnote 29 of the SCM Agreement states that pre-competitive research activity is early-stage R&D that is not directed at product development and is meant to benefit the entire industry instead of a single firm. It is usually undertaken for the purpose of developing a blueprint or plan for new, modified, or improved products, processes, or services, whether intended for sale or use, including the creation of a first prototype which would not be capable of commercial use. See JL Contreras and LS Vertinsky "Pre-Competition" (2016) 95 *North Carolina Law Review* 67 at 70.
[146] Footnote 31 of the SCM Agreement states that a general framework of regional development means that regional subsidy programmes are part of an internally consistent and generally applicable regional development policy and that regional development subsidies are not granted in isolated geographical points having no, or virtually no, influence on the development of a region.

(c) Assistance to promote adaptation of existing facilities to new environmental requirements imposed by law and/or regulations which result in greater constraints and financial burden on firms, provided that the assistance."[147]

Although a subsidy falling into one of the categories above could be recognised as a non-actionable subsidy, Article 9 provides a mechanism for WTO members to raise complaints about its subsequent impact on trade. Article 9.1 provides recourse for any WTO member that has reason to believe that the subsidy results in serious adverse effects on its domestic industry that are difficult to repair. Such a member may request consultations with the subsidising state to develop a mutually acceptable solution.[148]

Should the consultation not produce any results, the matter may be referred to the SCM Committee, which may request that modifications be made to the non-actionable subsidy. If this is not done, the Committee may authorise countermeasures.[149] Article 31 states that the provisions of Articles 8 and 9 were only applicable for five years from the date of entry into force of the Marrakesh Agreement. Furthermore, Article 31 states that before the lapse of the five years, the SCM Committee shall review the operation of the provisions and determine whether to extend their application.[150] However, the SCM Committee did not extend their operation, and the provisions have now lapsed.

Regional development subsidies provide important context through which to understand the currently unbalanced subsidy disciplines. Mainly, regional development subsidies may have provided a haven for countries which choose to establish EPZs as a part of their industrial development policies. The impact of retaining the provisions may have been the provision of more generous policy space than currently provided by the special and differential provisions of the SCM Agreement. This argument must be viewed in light of the fact that not every WTO member agreed with allowing the provisions of Article 8 to lapse, most notably India.

As the five-year period approached its end, the question of whether to extend the operation of Article 8 was discussed in several SCM Committee meetings. Three groups of countries emerged from the discussions. The first group included countries, mostly developed, that

[147] See Article 8.2 of the SCM Agreement for the entirety of this provision.
[148] Article 9.1 of the SCM Agreement.
[149] Articles 9.2, 9.3, and 9.4 of the SCM Agreement.
[150] These provisions were in operation for five years after the SCM Agreement came into force and Article 31 provided that if states wished to extend their operation, they could vote to do so before the five-year period ended.

supported the extension of the provisions as they were.[151] This group argued that in addition to the little experience regarding the use of the provisions,[152] it was too early to determine whether the provisions should be modified or if they served only a limited number of WTO members.[153] The second group of countries supported the lapse of the provisions primarily because the lack of their use meant that they had very little utility.[154]

The third group included developing countries that supported the lapse of the provisions on the basis that their operation favoured the interests of developed countries.[155] Alternatively, this group, particularly Brazil and India, were open to an extension of the provisions if they were modified. India suggested that Article 8.1 be expanded to include subsidies that would otherwise be prohibited by Article 3.1 if developing countries granted them.[156] Such an expansion would have the effect of making export subsidies and local content subsidies non-actionable when developing countries granted them.[157]

The impact of WTO member's refusal to expand Article 8, and its subsequent lapse, is that Article 27, which is discussed above, remains the only provision that offers flexibility for developing countries that grant subsidies that are covered by Article 3.1. Moreover, it reaffirms the SCM Agreement as one that does not take into account the policy justifications for a subsidy.[158] Therefore, as discussed in previous chapters, in the absence of provisions such as those in Article 8, the reason for government subsidisation does not provide any legal justification for the use of a prohibited subsidy.[159]

It was argued that allowing non-actionable subsidies to lapse would lead to a loss of the balanced structure of the SCM Agreement created by the categories of prohibited, actionable

[151] M Wu "Re-Examining 'Green Light' Subsidies in the Wake of New Green Industrial Policies" 2015 *E15Initiative, Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum* 1 at 3.
[152] Not once were the provisions invoked during their operation.
[153] Wu 2015 *E15Initiative, Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum* 3.
[154] Wu 2015 *E15Initiative, Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum* 4.
[155] *Ibid.*
[156] WTO Committee on Subsidies and Countervailing Measures "Minutes of the Regular Meeting Held on 1-2 November 1999" (2000) *G/SCM/M/24* para 36. See Bigdeli 2011 *Manchester Journal of International Economics* 9.
[157] Bigdeli 2011 *Manchester Journal of International Economics* 9.
[158] Charnovitz 2014 *World Bank Group Policy Research Paper 7060* 17.
[159] *Ibid.*

and non-actionable subsidies.[160] Specifically, it was argued with regard to environmental subsidies that this would form obstacles for countries that would need to address environmental problems through the use of subsidies.[161] Therefore, such countries would not have the ability to take advantage of non-actionable subsidies to fulfil their environmental objectives.

The argument about environmental subsidies has turned out to be accurate, as subsidies used to incentivise the transition to clean energy by countries such as India and, most notably, Canada, have been the subject of WTO disputes.[162] It is the absence of provisions in Article 8 that has led to the question of whether Article XX of the GATT may be used to justify subsidies geared towards environmental sustainability.

4.6.2 The root of the uncertainty regarding the applicability of Article XX

The question of whether Article XX of the GATT extends outside of the GATT itself stems from the fact that the texts of the GATT and the Marrakesh Agreement provide no clear nexus between Article XX and other WTO Agreements.[163] Furthermore, these agreements have provided contradictory clues about the relationship between GATT Article XX and other WTO agreements.[164] On the one hand, Article II:2 of the Marrakesh Agreement states that "the agreements and associated legal instruments included in Annexes 1, 2 and 3 ... are integral parts of this Agreement, binding on all members".

The WTO Appellate Body has interpreted the various agreements of the WTO as a single treaty instrument (a 'single undertaking'), under which all WTO members are bound by the obligations contained in the Marrakesh Agreement and its related Annexes.[165] This interpretation means that the agreements of the WTO must be read as representing rights and duties that are related to each other.[166] Therefore, the agreements must be interpreted as a

[160] WTO Committee on Subsidies and Countervailing Measures 2000 *G/SCM/M/24* para 24.
[161] *Ibid.*
[162] Bigdeli 2011 *Manchester Journal of International Economics* 3
[163] Y Ngangjoh-Hodu "Relationship of GATT Article XX Exceptions to Other WTO Agreements" (2011) 80 *Nordic Journal of International Law* 219 at 225.
[164] D Spiegel-Feld and S Switzer: Whither Article XX? Regulatory Autonomy Under Non-GATT Agreements After *China – Raw Materials*" (2012) 38 *Yale Journal of International Law Online* 17 at 20.
[165] Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut* (21 February 1997) WT/DS22/AB/R 12-13.
[166] Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear* (14 December 1999) WT/DS121/AB/R para 81; Appellate Body Report, *Korea – Definitive Safeguard Measures on Imports of Certain Dairy Products* (14 December 1999) WT/DS98/AB/R para 81.

whole to give meaning to all of them harmoniously.[167] Consequently, the Marrakesh Agreement and its associated Annexes are considered to form part of a single treaty and must be interpreted as such.

On the other hand, it is argued that the words of the introductory paragraph of GATT Article XX (referred to as the *chapeau*) restrict the application of its provisions to the GATT.[168] The words "... nothing in *this* agreement shall be construed to prevent the adoption ... of measures",[169] confines the applicability of Article XX to the GATT.[170] Specifically, it is argued that the omission of language explicitly expanding the reach of Article XX beyond the GATT, or referring to the Marrakesh Agreement signifies an intention not to expand its scope.[171] Therefore, in light of the conflicting views regarding Article XX's applicability beyond the GATT, the WTO Appellate Body's jurisprudence has sought to provide clarity on its framework.

4.6.3 The framework of Article XX of the GATT

One of the challenges the WTO faces is to ensure that the freedom of governments to implement legitimate policies is not compromised by the obligations placed on them by WTO agreements.[172] As a result, Article XX of the GATT contains exceptions that allow WTO members to implement legitimate policies where they would otherwise have violated the obligations imposed by the GATT, thus relieving them from these obligations.[173] Therefore, Article XX allows for policies that violate provisions of the GATT to be implemented despite being inconsistent with the GATT obligations when sufficient social or economic justification exists.[174]

According to Article XX:

[167] ABR, *Korea – Definitive Safeguard Measures* para 81.
[168] See Rubini 2012 *Journal of International Economic Law* 562; Spiegel-Feld and Switzer 2012 *Yale Journal of International Law* Online 20.
[169] Article XX of the GATT.
[170] *Ibid.*
[171] Spiegel-Feld and Switzer 2012 *Yale Journal of International Law Online* 20. This argument is strengthened when considered in light of the fact that Article 2.4 the Agreement on Sanitary and Phytosanitary Measures (the SPS Agreement) explicitly establishes a relationship between itself and GATT Article XX.
[172] Ngangjoh-Hodu 2011 Nordic Journal of *International Law* 221.
[173] S Bal "International Free Trade Agreements and Human Rights: Reinterpreting Article XX of the GATT" (2001) 10 *Minnesota Journal of Global Trade* 62 at 69.
[174] *Ibid.*

"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 the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement of measures:

a) Necessary to protect public morals;
b) Necessary to protect human, animal or plant life or health;
c) Relating to the importation and exportation of gold or silver;
d) Necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices;
e) Relating to the products of prison labour;
f) Imposed for the protection of national treasures of artistic, historic, or archaeological value;
g) Relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;
h) Undertaken in pursuance of obligations under any intergovernmental commodity which conforms to the criteria submitted to the Contracting Parties and not disapproved by them or which is itself so submitted and not so disapproved;
i) Involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan, provided that such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry, and shall not depart from the provisions of this Agreement relating to non-discrimination; and
j) Essential to the acquisition or distribution of foodstuffs or any other products in general or local short supply, provided that any such

> measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of the Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist."

To determine whether the exceptions in Article XX cover a measure, a two-tier test is applied. The test requires that the measure in question must fall under one of the paragraphs (a) to (j) listed in Article XX and, further, satisfy the requirements of the introductory paragraph of the provision.[175] The objective of having a two-tiered test is to ensure that even when a measure falls into one or more of the paragraphs in Article XX, this provision is not abused by countries that seek to implement trade-distortive policies.[176] Therefore, when a measure is covered by one of the specific exceptions, the next step is to determine whether it fulfils the requirements of the *chapeau*.

The *chapeau* of Article XX requires that a measure must not be applied in a manner that constitutes arbitrary or unjustifiable discrimination or a disguised restriction on international trade. Article XX requires that discrimination be arbitrary or unjustifiable to render a specific exception inapplicable because the nature of the exceptions is that countries affected by their application inherently experience discrimination.[177] Therefore, by adding these qualifications, the paragraph seeks to restrict discrimination against other countries that is disguised as legitimate policy by the member applying the measure.[178]

For instance, such arbitrary and unjustifiable discrimination has been found to exist where a WTO member uses an embargo to coerce other members to adopt the same regulatory regime as that which is in force in that member's territory.[179] In such a case, this is arbitrary and unjustifiable because the measure treats countries with different regulations differently, but does not take into account the conditions prevailing in those countries.[180] Therefore, although

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[175] Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline* (29 April 1996) WT/DS2/AB/R 22.
[176] Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products* (12 October 1998) WT/DS58/AB/R para 120. See PJ Alquisada "Reconciling Trade and Environment: GATT Article XX Exceptions, the Chapeau and the JPEPA" (2009) 53 *Ateneo Law Journal* 1027 at 1043.
[177] Bal 2001 *Minnesota Journal of Global Trade* 72.
[178] *Ibid.*
[179] ABR, *US – Shrimp* para 164.
[180] *Ibid.*

Article XX provides exceptions for measures that may be discriminatory towards other WTO members, the exceptions do not apply where such discrimination is arbitrary or unjustifiable.[181]

On the other hand, a country may not rely on the exceptions in Article XX if its measure constitutes a disguised restriction on international trade. A measure constitutes a disguised restriction on international trade if it is protectionist.[182] This condition ensures that the specific exceptions are not used to restrict trade more than necessary to achieve the desired result.[183] Ultimately, this condition ensures that WTO members' right to implement legitimate policies in their territories does not undermine the GATT's purpose of reducing barriers to international trade between them.[184]

4.6.4 Early jurisprudence involving Article XX and other WTO agreements

4.6.4.1 Early panel reports on Article XX's applicability

Before the Appellate Body intervened to decide the breadth of GATT Article XX's reach, three dispute settlement panels were asked to consider this question, and each of them avoided having to rule upon it. In *EC – Trademarks*,[185] the European Communities raised Article XX as a defence to its measures that were alleged to be inconsistent with the Agreement on Technical Barriers to Trade (the TBT Agreement).[186] However, the panel held that Australia had not established a *prima facie* case in support of its claim that the measures at issue violated the TBT Agreement.[187] As a result, the panel found it unnecessary to rule on whether Article XX applied to the TBT Agreement.[188]

In *EC – Biotech*,[189] the European Communities claimed that Article XX applied to the TBT Agreement.[190] In this dispute, the panel ruled that the challenged measures fell within the scope of the Agreement on Sanitary and Phytosanitary Measures (SPS Agreement), and not

[181] ABR, *US – Shrimp* paras 161-184; ABR, *US – Gasoline* 25-29.
[182] Alquisada 2009 *Ateneo Law Journal* 1044.
[183] Bal 2001 *Minnesota Journal of Global Trade* 74. See Appellate Body Report, Brazil – Measures Affecting Imports of Retreaded Tyres (3 December 2007) WT/DS332/AB/R paras 248-252.
[184] Bal 2001 *Minnesota Journal of Global Trade* 75.
[185] Panel Report, *European Communities – Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs* (15 March 2005) WT/DS290/R.
[186] PR, *EC – Trademarks* para 7.440.
[187] PR, *EC – Trademarks* para 7.475.
[188] PR, *EC – Trademarks* para 7.476.
[189] Panel Report, *European Communities – Measures Affecting the Approval and Marketing of Biotech Products* (29 September 2006) WT/DS291/R/ WT/DS292/R/ WT/DS293.
[190] PR, *EC – Biotech* para 4.357.

the TBT Agreement.[191] Therefore, it was unnecessary to consider whether Article XX applied to the TBT Agreement.[192] In *US – Customs Bond Directive*,[193] India specifically requested the panel to rule on whether the US should be allowed to invoke Article XX to defend its measures that allegedly violated the Anti-Dumping Agreement.[194]

In this dispute, the panel analysed whether the US's measures were consistent with the requirements of Article XX(d) without ruling on whether the defence was available for the US to invoke in a matter concerning a non-GATT agreement.[195] On appeal, the Appellate Body refused to rule on the availability of Article XX as a defence. The Appellate Body assumed *arguendo* that Article XX was available as a defence before also going on to rule on whether the US had satisfied the requirements of Article XX(d) [196] After the US unsuccessfully argued that its measures fell within the scope of Article XX(d), the Appellate Body concluded that it was unnecessary to rule whether Article XX was available as a defence.[197]

4.6.4.2 The Appellate Body's first ruling on Article XX: China - Audiovisuals

The first time the Appellate Body ruled on the breadth of Article XX's reach was in *China – Audiovisuals*. [198] As a part of its censorship program, China implemented measures concerning certain goods and services relating to (i) reading material such as books, periodicals and electronic publications; (ii) audiovisual home entertainment products such as DVDs; (iii) sound recordings; and (iv) films for theatrical release. [199] These measures specifically restricted the importation and distribution of such content in China.[200] The US challenged these measures, alleging that they were inconsistent with provisions of China's Accession Protocol, the GATT, and the General Agreement on Trade in Services (the GATS).

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[191] PR, *EC – Biotech* para 7.2524.
[192] *Ibid.*
[193] Panel Report, *United States – Customs Bond Directive for Merchandise Subject to Anti-Dumping/Countervailing Duties* (29 February 2008) WT/DS345/R.
[194] PR, *US – Customs Bond Directive* para 6.11.
[195] PR, *US – Customs Bond Directive* paras 7.287-7.313.
[196] Appellate Body Report, United States – Measures Relating to Shrimp from Thailand/ United States – Custom Bonds Directive for Merchandise Subject to Anti-Dumping/Countervailing Duties (16 July 2008) WT/DS343/AB/R/ WT/DS345/AB/R para 310.
[197] ABR, *US – Shrimp* (Thailand) para 319.
[198] Appellate Body Report, *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products* (21 December 2009) WT/DS363/AB/R.
[199] Panel Report, *China – Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products* (12 August 2009) WT/DS363/R para 2.1.
[200] PR, *China – Audiovisuals* para 2.2.

The most essential contention raised was that the measures in question unjustifiably restricted foreign enterprises and individuals from importing the above goods to China by limiting trading rights to Chinese state-owned enterprises.[201] The US argued that this restriction violated China's trading-right commitments as provided for in paragraph 5.1 of China's Accession Protocol (the Protocol),[202] which stated:

> "Without prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement, China shall progressively liberalize the availability and scope of the right to trade, so that, within three years after accession, all enterprises in China shall have the right to trade in all goods throughout the customs territory of China, except for those goods listed in Annex 2A which continue to be subject to state trading in accordance with this Protocol ..."

The US argued that this paragraph means every enterprise within China's territory, without exception, must have the right to trade and, therefore, the restrictions implemented by China were inconsistent with this provision.[203] China invoked Article XX(a) of the GATT as a defence.[204] Specifically, China argued that the phrase "without prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement" included the Marrakesh Agreement and its related Annexes.[205] China argued that its right to regulate trade must be interpreted in conjunction with WTO agreements regulating trade in goods, including the GATT.[206]

The panel assumed *arguendo* that Article XX was available to China as a defence and continued to analyse whether its measures satisfied the requirements of Article XX(a). much like in the disputes mentioned above, when China unsuccessfully argued that its measures satisfied the requirements of Article XX(a), the panel found it unnecessary to rule on whether Article XX was available to China.[207] On appeal, the Appellate Body criticised the panel for

[201] PR, *China – Audiovisuals* para 2.3.
[202] PR, *China – Audiovisuals* para 3.1.
[203] PR, *China – Audiovisuals* para 7.237.
[204] PR, *China – Audiovisuals* para 7.725.
[205] PR, *China – Audiovisuals* para 7.735.
[206] PR, *China – Audiovisuals* para 7.736.
[207] PR, *China – Audiovisuals* para 7.911.

assuming *arguendo* that Article XX was applicable instead of conducting the requisite analysis.[208]

When determining whether Article XX applied to the Protocol, the Appellate Body employed a textual approach.[209] It held that reference in paragraph 5.1 of the Protocol to China's right to regulate trade referred to its power to govern or control international commerce.[210] This is a right that could not be impaired, provided that it was exercised in a manner consistent with the Marrakesh Agreement.[211] In this context, the Marrakesh Agreement was taken to mean the Agreement, along with all its annexes.[212]

Furthermore, the Appellate Body held that a member's exercise of its rights to regulate might be WTO-consistent in two ways. Firstly, the exercise of such rights may simply not contravene any WTO obligation.[213] Secondly, the exercise of the right to regulate may be inconsistent with a member's WTO obligations, but still be justifiable under an applicable exception.[214] According to this interpretation, a measure's consistency is not only limited to satisfying the requirements imposed by the provisions of an agreement, but by satisfying the requirements of an exceptions clause in cases of inconsistency with the main provisions.

Ultimately, China's right to regulate trade in a manner consistent with the Marrakesh Agreement was interpreted as encompassing: (i) the exercise of rights that satisfies the requirements of WTO-covered agreements; and (ii) rights that derogate from WTO obligations, but comply with the requirements of any applicable exceptions.[215] For this reason, the Appellate Body concluded that Article XX was available to justify China's contravention of the Protocol.

4.6.4.3 China – Raw Materials

The next time that Article XX was addressed was in the *China – Raw Materials,*[216] and *China – Rare Earths,*[217] disputes. *China – Raw Materials* involved a complaint raised against

[208] ABR, *China – Audiovisuals* paras 213-215.
[209] See ABR, *China – Audiovisuals* paras 218-220.
[210] ABR, *China – Audiovisuals* para 221.
[211] *Ibid.*
[212] ABR, *China – Audiovisuals* para 222.
[213] ABR, *China – Audiovisuals* para 223.
[214] *Ibid.*
[215] *Ibid.*
[216] Panel Report, *China – Measures Related to the Exportation of Various Raw Materials* (5 July 2011) WT/DS394/R/ WT/DS395/R/ WT/DS398/R.

export restrictions imposed by China in respect of bauxite, coke, fluorspar, magnesium, manganese, silicon carbide, silicon metal, yellow phosphorus, and zinc (the "raw materials").[218] These materials are in demand because they are used to produce various products, including electronics, refrigerants, batteries and some medicines.[219] The export restraints imposed by China included: (i) export duties; (ii) export quotas; (iii) export licensing; and (iv) minimum export price requirements.[220]

The most important claim made by the complainants was that China's export duties were inconsistent with China's obligation in paragraph 11.3 of the Protocol read with its Annex 6.[221] Paragraph 11.3 obliges China to eliminate all the taxes and charges it applies to exports unless they are provided for in Annex 6 or they conform with Article VIII of the GATT. Annex 6 of the Protocol provides that the tariff levels set out therein are maximum levels, which will not be exceeded. Furthermore, the Annex provides that the rates applied will not be increased except under exceptional circumstances. If such circumstances occur, it will consult with affect WTO members prior to increasing such rates to find a mutually acceptable solution.[222]

The panel found that China's export duties were inconsistent with its obligations under paragraph 11.3 of the Protocol as well as Annex 6 of the Protocol.[223] In its defence, China argued that the export duties it imposed over some raw materials were justified according to Article XX(b) and XX(g) of the GATT.[224] Specifically, China argued that the wording of the Protocol together with the WTO agreements forming a single undertaking support China's right to invoke Article XX to justify its measures.[225]

The panel held that in *China – Audiovisuals*, the Appellate Body did not discuss the systemic relationship between the GATT and other WTO legal instruments, including the Protocol.[226] Instead, the Appellate Body focused its analysis on the text of the provisions of the Protocol

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[217] Panel Report, *China – Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum* (26 March 2014) WT/DS431/R/ WT/DS432/R/ WT/DS433/R.
[218] PR, *China – Raw Materials* para 2.1.
[219] Spiegel-Feld and Switzer 2012 *Yale Journal of International Law* Online 25.
[220] PR, *China – Raw Materials* para 2.1.
[221] PR, *China – Raw Materials* para 7.52.
[222] ABR, *China – Raw Materials* para 281.
[223] PR, *China – Raw Materials* para 7.105.
[224] PR, *China – Raw Materials* para 7.106.
[225] PR, *China – Raw Materials* para 7.110.
[226] PR, *China – Raw Materials* para 7.117.

that were at issue and the surrounding context and overall structure of the Protocol.[227] Furthermore, the panel held that the reason GATT Article XX was available to China to justify its measures in *China – Audiovisuals* was that its provisions were incorporated into the text of the relevant provisions.[228]

The panel noted that the text of paragraph 11.3 of the Protocol did not contain any references to GATT XX in the way that paragraph 5.1 did.[229] The panel concluded that the omission of Article XX from paragraph 11.3 of the Protocol indicated that China had no intention to incorporate the former into this provision.[230] Ultimately, the panel concluded that the text and context of paragraph 11.3 of the Protocol did not provide any possibility for China to invoke GATT Article XX to justify its export duties.[231]

On appeal, the Appellate Body upheld the entirety of the panel's GATT Article XX analysis.[232] Notably, the Appellate Body attached significance to the fact that paragraph 11.3 expressly referred to Article VIII of the GATT but did not contain any reference to Article XX.[233] This meant that China could not have recourse to GATT Article XX to justify export duties that were inconsistent with paragraph 11.3.[234] Consequently, the Appellate Body concluded that the panel did not err in finding that there is no basis in the Protocol to allow China to invoke Article XX to defend measures that are inconsistent with paragraph 11.3.[235]

4.6.4.4 China – Rare Earths

China – Rare Earths concerned China's imposition of export duties and export quotas on rare earths, tungsten, and molybdenum. Rare earths have a variety of uses, including in weapons systems, rechargeable batteries and clean energy products that are important for facilitating countries' transition to renewable energy.[236] In 2011, China accounted for 90 percent of the

[227] *Ibid.*
[228] PR, *China – Raw Materials* para 7.119.
[229] PR, *China – Raw Materials* para 7.124.
[230] PR, *China – Raw Materials* para 7.129.
[231] PR, *China – Raw Materials* para 7.158.
[232] China had argued before the WTO Appellate Body that the ruling by the panel that there had to be a textual reference to Article XX deprived China and other WTO members of their inherent right to regulate trade. See E Baroncini "The Applicability of GATT Article XX to China's WTO Accession Protocol in the Appellate Body Report of the China-Raw Materials Case: Suggestions for a different Interpretive Approach" (2013) 1 *China-EU Law Journal* 1 at 7.
[233] ABR, *China – Raw Materials* para 303.
[234] ABR, *China – Raw Materials* para 304.
[235] ABR, *China – Raw Materials* para 307.
[236] EW Bond and J Trachtman "China – Rare Earths: Export Restrictions and the Limits of Textual Interpretation" (2016) 15 *World Trade Review* 189 at 191.

global production of rare earths.[237] Due to overexploitation of its rare earth deposits, China started experiencing environmental degradation and resource depletion.[238] As a result, China started to restrict exports of rare earths to decrease mining activity without cutting supply to its domestic market.[239]

As in *China – Raw Materials*, the most crucial aspect of this dispute concerned export duties which China imposed on various types of rare earths in contravention of paragraph 11.3 of the Protocol.[240] China did not dispute that its export duties were inconsistent with paragraph 11.3 of the Protocol.[241] However, China argued, as it did in *China – Raw Materials* above, that its obligations in paragraph 11.3 are subject to GATT Article XX.[242] As a result, they argued that the export duties are justified under GATT Article XX(b) because they are "necessary to protect human, animal or plant life or health".[243]

China requested that the Panel reconsider the question of GATT Article XX's applicability to paragraph 11.3 of the Protocol in the light of arguments that had neither been made nor fully considered in *China- Raw Materials*. Two arguments that were made by China are essential for this study. Firstly, China argued that while there is no express language linking paragraph 11.3 of the Protocol to GATT Article XX, this did not mean that it was not the members' common intention that the defence should not be available to it.[244] This argument is based on *US – Carbon Steel,*[245] in which the Appellate Body remarked that:

> "The task of ascertaining the meaning of a treaty provision with respect to a specific requirement does not end once it had been determined that the text is silent on that requirement. Such silence does not exclude the possibility that the requirement was intended to be included by implication"[246]

[237] ABR, *China – Rare Earths* para 4.12.
[238] E Baroncini "The China-Rare Earths WTO Dispute: A Precious Chance to Revise the China-Raw Materials Conclusions on the Applicability of GATT Article XX to China's WTO Accession Protocol" (2012) 4 *Cuadernos de Derecho Transnacional* 49 at 52.
[239] *Ibid.*
[240] PR, *China – Rare Earths* para 7.30.
[241] PR, *China – Rare Earths* para 7.31.
[242] *Ibid.*
[243] *Ibid.*
[244] PR, *China – Rare Earths* para 7.63.
[245] Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany* (19 December 2002) WT/DS213/AB/R.
[246] ABR, *US – Carbon Steel* para 65.

Specifically, China argued that textual silence in a treaty provision does not, in and of itself, dispose of its ability to rely on Article XX.[247] The panel remarked that the Appellate Body,[248] did not treat the absence of a textual reference to Article XX in paragraph 11.3 of the Protocol as dispositive.[249] Instead, the panel held that the Appellate Body reached its conclusion by considering factors that included the rules of treaty interpretation, prior Appellate Body Reports and, *inter alia*, the ordinary meaning of the text of paragraph 11.3.[250] The panel concluded that the argument that 'textual silence in a treaty provision is not dispositive' was not a cogent reason to depart from the decision in *China – Raw Materials*.[251]

Secondly, China argued that a holistic interpretation that takes into account the object and purpose of the Marrakesh Agreement allows it to have recourse to Article XX to justify its export duties.[252] China argued that the Appellate Body summarily dismissed the interpretive value of the WTO's objectives without any further reasoning, and this was not an objective assessment of the legal issues that were put before it.[253] Furthermore, China argued that the result of the Appellate Body's conclusion that Article XX is inapplicable is that trade must be liberalised at the cost of members' right to regulate trade within their territories.[254] China argued that this was contrary to the object and purpose of the Marrakesh Agreement.[255]

The panel agreed with China that an interpretation of the WTO agreements in a way that took away members' rights to regulate trade within their territories would be inconsistent with the object and purpose of the WTO.[256] However, it subsequently held that this was not the result of the Appellate Body's decision in *China – Raw Materials*. The panel held that the result of the decision was that China could implement policies to decrease environmental degradation and resource depletion that were not export duties.[257] Ultimately, the panel held that there

[247] PR, *China – Rare Earths* para 7.64.
[248] Any reference to the Appellate Body in China's arguments means the Appellate Body Report in *China – Raw Materials*.
[249] PR, *China – Rare Earths* para 7.66.
[250] *Ibid.*
[251] PR, *China – Rare Earths* para 7.72.
[252] PR, *China – Rare Earths* para 7.105.
[253] PR, *China – Rare Earths* para 7.108.
[254] PR, *China – Rare Earths* para 7.110.
[255] *Ibid.*
[256] PR, *China – Rare Earths* para 7.114.
[257] PR, *China – Rare Earths* para 7.113.

was no cogent reason to derogate from the Appellate Body's decision that GATT Article XX was inapplicable to paragraph 11.3 of the Protocol.[258]

4.6.5 The result of the WTO's jurisprudence

The three disputes discussed above are significant because they establish an approach to interpretation that provides clarity on the relationship between GATT Article XX and the other covered agreements. In *China – Audiovisuals*, China was allowed to invoke GATT Article XX as a defence because paragraph 5.1 of the Protocol provides a textual link between the Protocol itself, and Article XX.[259] By contrast, in *China – Raw Materials* and, subsequently, *China – Rare Earths*, GATT Article XX was held to be inapplicable to paragraph 11.3 of the Protocol because a similar textual link was not present.[260]

In *China – Raw Materials*, the panel held that the Marrakesh Agreement does not contain an umbrella exceptions clause allowing members to derogate from their obligations in any WTO agreement because each agreement has its own specific exceptions that allow for this.[261] Furthermore, the panel held that the terms "nothing in this Agreement ..." in the *chapeau* of Article XX limits the exceptions in the Article to the GATT, and not to other agreements.[262] Therefore, the interpretation adopted in the WTO suggests that the default position regarding GATT Article XX is that the exceptions therein may only be invoked for violations of GATT obligations and not violations of other WTO agreements.[263]

However, the disputes discussed above indicate that Article XX is not absolutely excluded from being applied to exempt members from obligations outside of the GATT. Article XX may be invoked as a defence for violating provisions of an agreement outside of the GATT, provided that there is language to this effect incorporated in such an agreement.[264] For this reason, the applicability of Article XX to other Agreement is considered on a case-by-case basis and not analysed in terms of a general theory about the relationship between the GATT

[258] PR, *China – Rare Earths* paras 7.115-7.116.
[259] ABR, *China – Audiovisuals* paras 229-233.
[260] ABR, *China – Raw Materials* para 303; PR, *China – Raw Earths* paras 7.115-7.116.
[261] PR, *China – Raw Materials* para 7.150.
[262] PR, *China – Raw Materials* para 7.153. This statement was cited with approval by the panel in *China – Rare Earths* para 7.101. See ABR, *US – Shrimp* para 121, where the Appellate Body held that the Article XX contains exceptions to the substantive obligations that are established in the GATT.
[263] I Espa "The Appellate Body Approach to the Applicability of Article XX GATT in the Light of *China – Raw Materials*: A Missed Opportunity?" (2012) 46 *Journal of World Trade* 1399 at 1410.
[264] Espa 2012 *Journal of World trade* 1410. In *China – Audiovisuals*, the text of paragraph 5.1 of the Protocol did not explicitly mention Article XX, but the reference to "the right to regulated" led the panel and the Appellate Body to infer that China intended to have Article XX available as a defence.

and other WTO Agreements.[265] Ultimately, without explicit language indicating this, Article XX may not be invoked to justify violations of a member's trade commitments and obligations outside of the GATT.[266]

4.7 The influence of the WTO's jurisprudence on the AfCFTA

4.7.1 Implications for the SCM Agreement

For several reasons, the conclusions in these disputes have implications for the applicability of Article XX to the SCM Agreement. Firstly, the requirement for a textual link between a provision in question and GATT Article XX, and the lack of such language in the SCM Agreement, confirms the latter as a *lex specialis* agreement.[267] The SCM Agreement is listed as one of the 12 agreements in Annex 1A to the Marrakesh Agreement (Annex 1A). General Interpretive Note to Annex 1A provides that if there is conflict between the GATT and a provision of an Annex 1A agreement, the provision of the Annex 1A agreement will prevail to the extent of the conflict.

WTO case law,[268] construes 'conflict' in line with the principle of *lex specialis*.[269] According to this rule, where two different norms exist to regulate the same matter, the specific rule prevails over a general rule.[270] The rationale behind this principle is that where two provisions exist to regulate the same matter, giving preference to the general provision renders the specific one redundant.[271] Where subsidies are concerned, the rules in the SCM Agreement are *lex specialis* because they elaborate on the general subsidy provisions contained in Articles VI,[272] and XVI,[273] of the GATT.[274]

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[265] BJ Condon "Climate Change and Unresolved Issues in WTO Law" (2009) 12 *Journal of International Economic Law* 895 at 906; Spiegel-Feld and Switzer 2012 *Yale Journal of International Law Online* 27; ABR, *Brazil – Desiccated Coconut* 13.

[266] JY Qin "The Predicament of China's 'WTO-Plus' Obligation to Eliminate Export Duties: A Commentary on the China-Raw Materials Case" (2012) 11 *Chinese Journal of International Law* 1 at 4.

[267] An agreement is *lex specialis* where its provisions are specific and offer more clarity on general provisions that are contained in another, often overarching, agreement. See n268 below.

[268] See Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* (12 March 2001) WT/DS135/AB/R paras 75-77; Panel Report, *European Communities – Trade Description of Sardines* (29 May 2002) WT/DS231/R paras 7.14-7.19.

[269] For instance, in *EC – Asbestos* the Appellate Body held distanced itself from a panel ruling which opted for a review of challenged measures in terms of the GATT instead of the more specific TBT Agreement.

[270] C Tran "Using GATT, Art XX to Justify Climate Change Measures under the WTO Agreements" (2010) 27 *Environmental and Planning Law Journal* 346 at 357.

[271] PC Mavroidis *The Regulation of International Trade Volume 1: GATT* (2016) 86.

[272] Article VI of the GATT regulates countervailing duties.

[273] Article XVI of the GATT contains general provisions on the use of subsidies.

[274] ABR, *Brazil – Desiccated Coconut* 14. Condon 2009 *Journal of International Economic Law* 906.

The SCM Agreement contains no textual references to Article XX of the GATT. This is in contrast, for instance, to the Agreement on Trade-Related Investment Measures (TRIMS), which explicitly states that all exceptions in the GATT are applicable.[275] It is argued that the lack of any textual reference to Article XX in the SCM Agreement is an indication the latter is meant to regulate the use of subsidies without any reference to the GATT. Therefore, one of the results of the WTO's rulings is that the SCM Agreement, as a *lex specialis*, cannot be interpreted to allow for the applicability of GATT Article XX exceptions.[276]

Secondly, and closely related, the fact that the SCM Agreement classified subsidies into prohibited, actionable and non-actionable signifies that the SCM was not utterly silent on the relationship between it and GATT Article XX.[277] The context,[278] of the SCM Agreement supports the conclusion that non-actionable subsidies were intended to be the only provision dealing with subsidies that are exempt from provisions of the SCM Agreement.[279] In *China – Raw Materials*, the Appellate Body remarked that it understood the Marrakesh Agreement to reflect a balance that WTO members struck between trade and non-trade-related interests.[280]

However, the Appellate Body further held that the fact that such a balance exists does not provide any guidance as to whether Article XX must be applied to paragraph 11.3 of the Protocol.[281] This means that cognisance that a balance exists between trade and non-trade-related interests is not by itself an indication that where such interests conflict with each other, GATT Article XX may be invoked as a defence. Therefore, there must be a concrete reason beyond such cognisance to believe that a WTO member intended to make Article XX available.[282] Without such a concrete reason, holding that Article XX is applicable would certainly upset this balance.[283]

[275] Article 3 of TRIMS. Similarly, the TBT Agreement specifically incorporates all the exceptions of GATT Article XX that are relevant to its application. See Mavroidis *The Regulation of International Trade* 622.
[276] Tran 2010 *Environmental and Planning Law Journal* 358 argues that interpreting the GATT Article XX as being applicable to the SCM Agreement [in the absence of any textual reference to the former] undermines the *lex specialis* principle.
[277] *Ibid.*
[278] This includes the negotiating record, submissions by different WTO members, and documents by the WTO secretariat.
[279] Mavroidis *The Regulation of International Trade* 626.
[280] ABR, *China – Raw Materials* para 306.
[281] *Ibid.*
[282] Spiegel-Feld and Switzer 2012 *Yale Journal of International Law* Online 28.
[283] *Ibid.*

For this reason, the Appellate Body cannot read something into the text of another WTO agreement that is not there.[284] This is important in light of the SCM Agreement because it makes no explicit or implicit reference to Article XX. Specifically, it is arguable that the existence of Article 8 of the SCM Agreement and its subsequent lapse indicates that this was intended to be the only exemption in the SCM Agreement. Furthermore, it indicates that there was no intention to make Article XX available to justify violations of the SCM Agreement.[285] Ultimately, the result of the WTO's conclusions in the disputes above is that Article XX is not available to justify violations of the SCM Agreement.

4.7.2 Effect on the AfCFTA Agreement

The fact that prohibited subsidies are incapable of justification is a result of the purpose of the drafters of the SCM Agreement. Such an interpretation may trickle down to the AfCFTA when the relationship between the subsidy provisions in the Guidelines and the exceptions clause in the Protocol on Goods is interpreted. This is because the fact that export subsidies and local content subsidies are automatically considered to distort trade,[286] is likely to influence an interpretation of Guideline 29.2 in line with WTO subsidy laws. However, it is possible to adopt an interpretive approach in the AfCFTA that takes into account the object and purpose of the Protocol on Goods and the AfCFTA Agreement.

The importance of the WTO's rulings in the disputes above does not lie in its conclusions, but rather in the criticism of the panel and Appellate Body's strict textual approach to interpreting the relationship between the GATT and other WTO agreements. The basis of the criticism is that a strict textual interpretation of the provisions of WTO agreements will lead to WTO members' obligations trumping public policy and non-trade values.[287]

Furthermore, there is an argument that there should be a non-textual basis upon which the GATT is applied to other WTO agreements: members expect that there are circumstances in which their WTO obligations should yield to their public policy goals.[288] For this reason, Article XX, in matters concerning trade in goods, should be the basis upon which acceptable claims for exception are distinguished from unacceptable claims.[289] Ultimately, balancing

[284] *Ibid.*
[285] Mavroidis *The Regulation of International Trade* 626.
[286] The effects of prohibited subsidies are analysed in chapters 2.3.3, 3.2.3 and 4.3.2.
[287] Qin 2012 *Chinese Journal of International Law* 4.
[288] Bond and Trachtman 2016 *World Trade Review* 193.
[289] *Ibid.*

members' obligations and their right to regulate trade is better achieved through reference to the context, object and purpose of the WTO, rather than a strictly textual approach to interpretation.[290]

These arguments are essential in light of the AfCFTA Agreement because Article 25 of the Protocol on Goods contains exceptions that are worded precisely the same way as the exceptions in the GATT. There is a significant difference in structure between the GATT and the AfCFTA Agreement. As discussed above, although the SCM Agreement forms an integral part of the Marrakesh Agreement and is an elaboration of the general principles contained in the GATT, it is a separate, *lex specialis*, agreement dealing with trade in goods.

In contrast, the rules regulating subsidies in the AfCFTA Agreement are found in a protocol that regulates trade in goods, but they do not form part of a separate, *lex specialis* agreement.[291] Therefore, unlike the difficulty faced in balancing non-trade or public policy objectives with trade obligations in the context of the SCM Agreement, the hurdle faced by states in the AfCFTA is different because of the structure of the AfCFTA Agreement. As such, the same textual connection required between the GATT and the SCM Agreement may not be relevant in light of the AfCFTA Agreement.

Due to the transplant of the WTO's subsidy provisions and the GATT's exceptions clause into the AfCFTA Agreement, uncertainty remains as to whether the use of prohibited subsidies may be justified by invoking the exceptions contained in the Protocol on Goods. In light of this, the principles of treaty interpretation are essential.[292] The question addressed in this section is whether the inability to raise exceptions at WTO level also implies that the use of prohibited subsidies in the AfCFTA cannot be justified. It is argued here that the arguments put forward about an alternative interpretation to the WTO's textual approach find better application in the AfCFTA than the WTO.

4.7.3 Application of the Vienna Convention's principles of interpretation in the AfCFTA

[290] *Ibid.*

[291] See International Trade Centre "A Business Guide to the African Continental Free Trade Area Agreement" 2018 *ITC, Geneva* iii at 14-16 on the structure of the AfCFTA Protocol on Goods.

[292] JL Dunoff and MA Pollack *Interdisciplinary Perspectives on International Law and International Relations: The State of the Art* (2013) 447 makes the argument that the rigidity of treaties makes legal interpretation important because unlike national legislation, which can easily be changed, this is not the case for international treaties because all the parties to an agreement would need to agree to change the contents of an agreement.

The principles relating to the interpretation of treaties are contained in Articles 31(1) and (2) of the Vienna Convention. Article 31(1) states that "a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose". Article 31(2) states that "the term 'context' includes, in addition to the text, including its preamble and associated annexes:

a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty."

The principle of good faith, whose application is required by Article 31 of the Vienna Convention when interpreting a treaty, governs the entire interpretive process.[293] Although there is no definition for 'good faith', it is accepted that it constitutes a requirement of reasonableness.[294] In essence, the principle encapsulates the notion that the interpretation of a treaty's text must not lead to a conclusion that is manifestly absurd or unreasonable.[295] Furthermore, the principle of good faith prevents an overly literal interpretation of a treaty by requiring interpreters to consider the context of the provision in question.[296] This means that any interpretation of the treaty's text must be made in light of its context.[297]

The preamble of the AfCFTA Agreement and its objectives, as well as the objectives of the Protocol on Goods, are essential when interpreting whether the exceptions in Article 25 of the Protocol on Goods may be used to justify subsidies that infringe Guideline 29. The preamble of the AfCFTA Agreement reaffirms members' right to regulate trade within their territories as well as the flexibility to achieve their policy objectives. Furthermore, as mentioned in the second chapter above, Article 3 of the AfCFTA Agreement states that the general objectives of the AfCFTA "are to:

[293] Baroncini 2012 Cuadernos de Derecho Transnacional 61.
[294] O Dörr and K Schmalenbach Vienna Convention on the Law of Treaties: A Commentary (2012) 548.
[295] *Ibid.*
[296] ME Villiger *A Commentary on the 1969 Vienna Convention on the Law of Treaties* (2009) 426.
[297] See ABR, *US – Gasoline* 17-18; Panel Report, *United States – Final Anti-Dumping Measures on Stainless Steel from Mexico* (20 December 2007) WT/DS344/R paras 6.15-6.16; Appellate Body Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts* (12 September 2005) WT/DS269/AB/R/ WT/DS286/AB/R paras 238-239.

d) promote and attain sustainable and inclusive social and economic development, and gender equality and structural transformation of the State Parties;
e) enhance the competitiveness of the economies of State Parties within the continent and at the global market;
f) promote industrial development through diversification and regional value chain development, Agricultural Development and Food Security;"

Finally, the preamble of the Protocol on Goods states that members have "resolved to enhance competitiveness at the industry and enterprise level through exploiting opportunities for scale production, continental market access and imposed allocation of resources". Moreover, Article 3 of the Protocol on Goods states that its objectives "are to:

1. support the objectives of the AfCFTA, as set out in Article 3 of the Agreement, particularly to create a liberalised market for trade in goods.
2. Boost intra-African trade in goods through:
    f) enhanced socio-economic development, diversification, and industrialisation across Africa."

Three arguments arise from applying the principle of good faith and considering the objects and purpose of both the AfCFTA Agreement as well as the Protocol on Goods. Firstly, a reasonable interpretation of the provisions of Guideline 29.2 requires that this provision must be considered together with the rest of the Protocol on Goods and the AfCFTA Agreement as cumulative and simultaneously applicable.[298] Such an approach ensures an interpretation that takes into account members' obligations in Guideline 29.2 and their rights in Article 25 of the Protocol on Goods.[299] This argument is significant because it provides a basis on which to examine the AfCFTA Agreement in its entirety.

Secondly, the objectives of the AfCFTA Agreement and the Protocol on Goods frame trade liberalisation as a means to achieve goals such as the competitiveness of African economies in Africa and globally and sustainable development.[300] This means that trade liberalisation is

[298] Condon 2009 *Journal of International Economic Law* 905.
[299] *Ibid.* Although this argument was made in light of the SCM Agreement, it is equally applicable to the rights and obligations contained in the AFCFTA Agreement.
[300] Baroncini 2012 *Cuadernos de Derecho Transnacional* 64. Baroncini specifically makes the argument that trade liberalisation is not the final target of the Marrakesh Agreement.

not an end in itself, but rather a means to increase members' standard of living.[301] Moreover, this frames trade liberalisation commitments as obligations that are not absolute and may be derogated from if there are circumstances which require members to pursue policy objectives instead of their trade commitments.[302]

Some of the critical factors that limit the amount of intra-African trade include the lack of competitiveness and diversification in countries' industries which, as discussed in previous chapters, is caused by the fact that many countries still specialise in raw materials. Even if trade becomes more liberal, significantly reducing trade barriers, these factors may still hinder the effectiveness of the AfCFTA.[303] The result is that unless the factors which currently limit the rate of intra-African trade are addressed, it will be difficult to completely take advantage of the benefits of liberalising trade within the continent.

Guideline 29.2 and the exceptions in Article 25 of the Protocol on Goods need to be understood in this context. Although the trade liberalisation commitments in the AfCFTA Agreement and its related protocols play a pivotal role in ensuring that the objectives above are met, these objectives also envisage policy space for AfCFTA members. An approach that takes this context into account averts the risk of imposing, through judicial interpretation, obligations that members did not expressly accept and which they may not have accepted at all.[304] This argument is important when considered in light of the fact that the Guidelines regulating subsidies are a part of the Protocol on Goods and not a separate agreement.

According to Article 2 of the Protocol on Goods, Annex 9 and, by implication, its related guidelines form an integral part of the Protocol. As argued above, each of these texts is part of a single instrument that deals with trade in goods. Consequently, they must be interpreted as such. For this reason, it is argued that Article 25 of the Protocol is meant to authorise measures that would otherwise have violated the Protocol's provisions had it not been inserted because they threaten other members' market access benefits.[305] Therefore, it would be unreasonable to interpret the exceptions in Article 25 of the Protocol on Goods as

[301] *Ibid.*
[302] *Ibid.*
[303] African Union Commission and United Nations Economic Commission for Africa "Boosting Intra-African Trade: Issues Affecting Intra-African Trade, Proposed Action Plan for Boosting Intra-African Trade and Framework for the Fact Tracking of a Continental Free Trade Area" 2012 1 at 14.
[304] Qin 2012 *Chinese Journal of International Law* 5.
[305] M Fitzmaurice *et al Treaty Interpretation and the Vienna Convention* on the Law of Treaties: 30 Years On (2010) 118.

inapplicable in the case of subsidies when they are available to justify violations of other provisions in the Protocol.

Thirdly, Article 8 of the AfCFTA Agreement states that the Protocol on Goods forms an integral part of the Agreement. This means that Guideline 29.2 must also be interpreted in light of the object and purpose of the AfCFTA Agreement. The preamble of the AfCFTA Agreement reaffirms members' right to regulate within their territories and the flexibility they need to achieve their policy goals. This affirmation serves as evidence of a desire for the AfCFTA Agreement to maintain a balance between members' trade obligations and their right to regulate.[306]

The link between the right to regulate and the AfCFTA provisions relating to subsidies is the fact that the use of a prohibited subsidy may result from an AfCFTA member's exercise of their right to regulate.[307] It must be noted that where a treaty is open to more than one interpretation, the principle of good faith and the objects and purpose of the treaty require that the interpretation which enables the treaty to have appropriate effects is preferred.[308] Therefore, applying the exceptions in Article 25 of the Protocol on Goods to justify prohibited subsidies favours an interpretation which gives effect to the balance that members have attempted to strike between trade and non-trade interests.

Furthermore, such an approach results in a holistic interpretation of the AfCFTA Agreement and its Protocols that considers the text of guideline 29.2 in the context of the entire treaty and not in isolation from it.[309]An interpretation which is contrary to this has adverse effects because it leads to an interpretation of the AfCFTA Agreement that effectively results in a restriction of a member's right to regulate trade within their territory.[310] Ultimately, it is argued that interpreting the Protocol on Goods in a way that renders Article 25 inapplicable to violations of Guideline 29.2 is manifestly absurd and unreasonable.

[306] Bond and Trachtman 2016 *World Trade Review* 193; Qin 2012 *Chinese Journal of International Law* 7; Villiger *A Commentary on the 1969 Vienna Convention* 427.
[307] J Pauwelyn "Squaring Free Trade in Culture with Chinese Censorship: The WTO Appellate Body Report on *China – Audiovisuals*" (2010) 11 *Melbourne Journal of International Law* 119 at 137.
[308] Villiger *A Commentary on the 1969 Vienna Convention* 428.
[309] Dörr and Schmalenbach *Vienna Convention* 547; Fitzmaurice *et al Treaty Interpretation and the Vienna Convention* 116.
[310] Bond and Trachtman 2016 *World Trade Review* 193.

Ultimately, the debate about Article XX's application may influence the AfCFTA in two ways. Firstly, it is argued that even though the AfCFTA Agreement is structurally different from the SCM Agreement, with the former being a *lex specialis* agreement, the use of prohibited subsidies may still be interpreted as incapable of being justified. As noted above,[311] the classification of export and local content subsidies as prohibited is significantly influenced by the perception that these subsidies are specifically designed to distort trade. Unless the legal interpretation in the AfCFTA is based on a different perspective, this view of the nature of export and local content subsidies is likely to permeate into the AfCFTA.

Additionally, it is argued that the AfCFTA's jurisprudence must consider the commentary about the danger of adopting an interpretation of subsidy provisions that is primarily textual and which ignores the objects and purpose of the Protocol on Goods.[312] In this light, it is vital to take into account the principles of treaty interpretation to avoid inconsistencies in the application of the provisions of the Protocol on Goods. It is further argued that to avoid uncertainty similar to that in the WTO, AfCFTA jurisprudence needs to adopt an approach to interpretation that renders the exceptions clause applicable to the Guidelines.

4.8 Conclusion

Two conclusions arise from this discussion. Firstly, it seems that it is currently impossible to read the exceptions in GATT Article XX into the SCM Agreement because of the nature of the latter as a *lex specialis* agreement that has no textual reference to the GATT itself. Therefore, although some commentators disagree with the approach adopted by the Appellate Body when clarifying the relationship between the SCM Agreement and the GATT, this by itself is unlikely to change the Appellate Body's views on this subject. As a result, it is possible that in future disputes, the question of the GATT's applicability will be decided using the same reasoning.

Secondly, the commentary on the Appellate Body's approach to interpretation is important. In the context of the AfCFTA Agreement, the existing commentary illustrates that interpreting members' rights and obligations in light of the principle of good faith and the objects and purpose of the AfCFTA may help give effect to members' right to regulate. Therefore, to ensure that balance is maintained between members' rights to regulate trade in

[311] See paragraph 4.7.1 above.
[312] The objects and purpose of the Protocol on Goods and the AfCFTA Agreement have been discussed in the preceding section.

their territories and their trade commitments, Guideline 29.2 must be interpreted in a manner that allows members to justify their subsidies if they violate this provision. Furthermore, Guidelines 29.2 must be interpreted in a way that takes into account the anti-competitive effects of prohibited subsidies. An interpretation contrary to this would be manifestly unjust and unreasonable.

Chapter 5: The role of competition policy in the regulation of prohibited subsidies

5.1 Introduction

The previous chapter involved a discussion of the special and differential provisions of the WTO, and why they apply in the AfCFTA. The inclusion of special and differential provisions and the reference to them in the AfCFTA indicates a recognition that developing countries may need to use export subsidies for their development. However, the fact that they do not apply to all the members of the AfCFTA necessitated an analysis of whether Article 25 of the Protocol on Goods could be invoked to justify the use of prohibited subsidies. As a result, the chapter concluded that the exceptions in Article 25 of the Protocol on Goods could be invoked to justify subsidies that are inconsistent with Guideline 29.2.

The first section of this chapter involves a brief discussion of the limitations of Article 25 of the Protocol on Goods for countries seeking to use prohibited subsidies to improve their competitiveness. Specifically, it is argued in this chapter that the limitations in Article 25 call for a more systematic treatment of the anti-competitive effects of prohibited subsidies. Specifically, the section involves a discussion of the fact that Article 25 cannot be used to justify the use of measures that are designed to affect competition within markets. The second section involves a discussion of why there is a need for a more systematic treatment of hybrid restraints in competition policy. Arguably, dealing with subsidies as hybrid restraints on competition within markets will allow the AfCFTA to regulate prohibited subsidies more effectively.

The third section includes an analysis of the European Union (EU) rules on state aid which regulate government subsidisation in the EU. This comparative analysis has two aims. Firstly, it highlights instances in which subsidies are regulated differently from the overall WTO system to serve the needs of the European continent better. Secondly, it highlights the treatment of government subsidisation as a measure that affects competition within EU markets and the lessons that this can provide for the AfCFTA.

5.2 The limitations of Article 25 of the Protocol on Goods

As noted in the previous chapter, Article 25 of the Protocol on Goods allows governments to implement measures that would otherwise be illegal according to the Protocol on Goods, provided that they fall into the policy areas listed therein. To prove that a measure falls into one of the exceptions in Article 25, the member state implementing the measure must prove that there is a nexus between the measure in question and the specific exception.[1] This means that an AfCFTA member state must prove that the measure at issue is designed to carry out one of the exceptions listed in Article 25.

Whether there is a nexus between the measure in question and a specific exception depends on:

a) the importance of the aims that the measure pursues;
b) its trade-restrictiveness; and
c) the extent to which the measure contributes to the aims it is pursuing.[2]

The extent to which the measure contributes to its objective is significant in the context of subsidisation. The exceptions in Article 25 contain no grounds for measures such as export and local content subsidies that are inconsistent with the obligations of AfCFTA member states under the Protocol on Goods, but that have pro-competitive effects in the market.

The lack of grounds for measures that protect member states' policy space in the area of competition has several implications for the regulation of the use of prohibited subsidisation. Firstly, practice in the application of Article XX in the WTO shows that the exceptions deal with measures that discriminate between the goods originating from a country's domestic industry and those that do not.[3] The transplant of Article XX verbatim into the Protocol on Goods indicates a similar objective in the AfCFTA.[4] The exceptions were not formulated to

[1] T Eres "The Limits of GATT Article XX: A Back Door for Human Rights" (2004) 35 *Georgetown Journal of International Law* 597 at 616; R Harris and G Moon "GATT Article XX and Human Rights: What Do We Know from the First 20 Years" (2015) 16 *Melbourne Journal of International Law* 432 at 451.

[2] Harris and Moon 2015 *Melbourne Journal of International Law* 454; Eres *Georgetown Journal of International Law* 616.

[3] In CM Maas "Should the WTO Expand GATT Article XX: An Analysis of United States – Standards for Reformulated and Conventional Gasoline" 1996 *Minnesota Journal of Global Trade* 415 at 424, an argument is made that panels will not automatically find discriminatory measures invalid because they must evaluate whether the discrimination adversely affects a foreign product and whether such discrimination serves to neutralise an adverse effect.

[4] This is evidenced by the commitment enumerated in Article 4(c) of the AfCFTA Agreement to cooperate on the establishment of a competition policy, which would deal directly with conditions of competition in the AfCFTA.

deal directly with measures affecting conditions of competition within markets, which is what subsidies do.[5]

The focus on discrimination is illustrated by the fact that the majority of WTO case law in which Article XX of the GATT is invoked involves situations where foreign countries' goods are discriminated against because of a measure implemented by the respondent state.[6] In such disputes, the member implementing the measure was required to show that there is a connection between the product subjected to discrimination and the risk being averted.[7] This focus is further illustrated by the requirement in the *chapeau* of Article XX that a measure must not be applied in a manner that constitutes unjustifiable discrimination between countries where the same conditions prevail.[8]

The requirement that a measure must not constitute unjustifiable discrimination in the *chapeau* means that the reasons for the discrimination between like products must have a rational connection to an objective that falls under Article XX.[9] These exceptions are unlikely to apply in cases where a country adopts export subsidies. This is because the impact of an export subsidy is felt in a country other than that which implements the measure, and the exceptions only exempt measures that are applied domestically. Therefore, because the exceptions in Article 25 aim to protect a member's right to regulate trade domestically, they will not apply to measures not directed at a member's domestic territory.[10]

In the case of local content subsidies, it is possible to imagine a situation where subsidisation results in discrimination between domestic and imported products. However, it may still be challenging to justify the use of the subsidy because none of the grounds in Article 25 of the

[5] The effects of export and local content subsidies on competition are discussed in chapter 2.

[6] See ABR, *EC – Asbestos* paras 2-4; ABR, *US – Gasoline* 4-9; Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef* (11 December 2000) WT/DS161/AB/R/ WT/DS169/AB/R paras 1-5; Appellate Body Report, *European Communities – Measures Prohibiting the Importation and marketing of Seal Products* (22 May 2014) WT/DS400/AB/R/ WT/DS401/AB/R paras 1.4-1.5.

[7] Eres *Georgetown Journal of International Law* 617. In ABR, *EC – Asbestos* para 163, the Appellate Body remarked that a connection needs to be shown between the banning of asbestos and the need to protect human lives.

[8] Article XX of the GATT.

[9] GM Duran "Measures with Multiple Competing Purpose after *EC: Seal Products*: Avoiding a Conflict between GATT Article XX-Chapeau and Article 2.1 TBT Agreement" (2016) 19 *Journal of International Economic Law* 467 at 475.

[10] Harris and Moon 2015 *Melbourne Journal of International Law* 454 highlight that there has not been any ruling by the WTO Appellate Body as to whether GATT Article XX protects measures that are outwardly directed. Therefore, until there is a jurisprudence in the AfCFTA regarding this, it cannot be argued that Article 25 of the Protocol on Goods protects outwardly directed measures.

Protocol on Goods mainly deal with the use of local content subsidisation. For instance, this may be the case where such subsidisation is meant to develop infant industries in AfCFTA member states. While this is a legitimate policy objective, it is not listed in Article 25. Therefore, the exceptions may still limit members' ability to implement measures for their development because Article 25 is a closed list.

Secondly, seeking to use Article 25 to justify the use of prohibited subsidies highlights the limited list of policy objectives that a member may pursue, as discussed above. Moreover, it would confer considerable power to the AfCFTA's dispute settlement body.[11] This is more so when it is considered that the dispute settlement body will have the power to decide whether a subsidy falls into any of the exceptions in Article 25. Allowing adjudicating bodies to determine the legitimacy of measures that affect competition within the market, by applying trade law that does not give room for them to consider whether measures have pro-competitive effects, only exacerbates the gap in regulation which currently exists.

Moreover, making Article 25 the avenue that AfCFTA members must go through to justify their measures may lead to claims that the exceptions in the Article apply to subsidies. If such claims are successful, the result may be that the scope of the exceptions is extended beyond what the members intended it to be when they drafted the provisions.[12] Therefore, even though legal interpretation allows AfCFTA members to invoke the exceptions in Article 25, this is unlikely to assist in resolving the problems they face in their use of prohibited subsidies.

Arguably, the AfCFTA needs a more systemic way of dealing with the use of prohibited subsidies. The market-oriented nature of competition law may provide a more suitable basis for the regulation of prohibited subsidies. For this reason, it is argued in the sections that follow that competition policy may play an integral part in regulating the use of prohibited subsidies in the AfCFTA.

5.3 The relevance of competition policy in the regulation of government subsidies

[11] J Pauwelyn "Squaring Free Trade in Culture with Chinese Censorship: The WTO Appellate Body Report on *China – Audiovisuals*" (2010) 11 *Melbourne Journal of International Law* 119 at 138. While this argument was made in light of subparagraphs in GATT Article XX that require a member to prove that its measure is necessary to achieve a particular policy objective, it is argued that it is generally applicable to the arguments made in this section concerning the AfCFTA.

[12] *Ibid.*

As mentioned in the introductory chapter, competition policy refers to all the measures that a government can use to promote competitive behaviour and protect the process of competition in markets.[13] These measures may include the enactment of competition law and measures aimed at achieving trade liberalisation.[14] This section discusses the suitability of competition policy to address the inefficiencies of trade policy in addressing the effects of export and local content subsidisation on competition within markets.

5.3.1 The differences between competition policy and trade policy

There are two significant differences between competition and trade policy that are worth noting.[15] The first difference relates to their scope and objectives. Trade policy has an international outlook, and principally focuses on the behaviour of countries.[16] Its goal is to achieve free trade and market liberalisation by eliminating or reducing barriers that restrict countries' market access.[17] Trade policy is usually concerned with measures implemented by a government that result in discriminatory treatment towards goods from foreign producers.[18]

The foundation of trade policy is cooperation between different governments. Notably, international trade is premised on the notion of governments undertaking to provide access to their domestic markets to each other.[19] Countries are incentivised to open their markets to foreign producers. Ideally, the gains that a country's producers make by accessing foreign markets outweighs the discomfort caused by the increased foreign competition in that country's domestic industry.[20] Therefore, trade policy ensures that reciprocity between countries is sustained. It is for this reason that trade policy is said to be concerned with protecting the interests of producers.[21]

On the other hand, competition policy tends to have a national outlook. It is concerned with ensuring that the behaviour, conduct and transactions of firms within domestic markets is not

[13] *World Trade Organisation* "Report (1998) of the Working Group on the Interaction between Trade and Competition Policy to the General Council" 1998 *WT/WGTCP/2* para 20.
[14] *Ibid.*
[15] Although there are more differences between competition policy and trade policy, only the ones which are most important to the analysis carried out later in this chapter are discussed here.
[16] MM Dabbah *International and Comparative Competition Law* (2010) 590.
[17] SW Chang "Interaction Between Trade and Competition: Why a Multilateral Approach for the United States?" (2004) 14 *Georgetown Journal of International Law* 1 at 6; Dabbah *Comparative Competition Law* 590.
[18] *World Trade Organisation* 1998 *WT/WGTCP/2* para 23.
[19] RE Hudec "A WTO Perspective on private Anti-Competitive Behavior in World Markets" (1999) 34 *New England Law Review* 79 at 82.
[20] *Ibid.*
[21] Chang 2004 *Georgetown Journal of International Law* 7; Dabbah *Comparative Competition Law* 590.

anti-competitive.[22] As discussed above, the goals of competition policy are to protect consumers and ensure economic efficiency by promoting competition within markets.[23] Therefore, competition policy is concerned with regulating measures that affect the conditions of competition and the behaviour of enterprises within a country's domestic market.[24]

Competition policy has a national outlook because it primarily represents national attitudes about what social and political impact the economic structure of a country must have.[25] The focus of competition policy on economic efficiency and consumer welfare is meant to ensure that the role that the economic structure must play is not adversely affected by the anti-competitive behaviour and conduct of firms within the domestic market. Unlike trade policy, competition policy seeks to achieve consumer welfare by protecting consumers and not competitors.[26]

The second difference between competition and trade policy is that they often prescribe different standards for determining whether a measure is illegal. For instance, under trade policy, private vertical restraints are condemned where it is established that they impede on countries' market access commitments.[27] This is because trade policy would be concerned with whether the measure prevents access to the market for a foreign producer. Under competition policy, the legality of such restraint may depend on factors such as the market power of the firm involved in the conduct and whether the conduct has any pro-competitive effects on the market.[28] Therefore, the same conduct that may be illegal under trade policy may be legal under competition policy.

5.3.2 The intersection between competition and international trade

[22] Dabbah *Comparative Competition Law* 590; *World Trade Organisation* 1998 *WT/WGTCP/2* para 23.
[23] See paragraph 2.3.1 above; J Epstein "The Other Side of Harmony: Can Trade and Competition Laws Work Together in the International Marketplace" (2002) 17 *American University International Law Review* 343 at 345.
[24] *World Trade Organisation* 1998 *WT/WGTCP/2* para 23.
[25] Hudec 1999 *New England Review* 82.
[26] Chang 2004 *Georgetown Journal of International Law* 7; Hudec 1999 *New England Review* 83.
[27] Chang 2004 *Georgetown Journal of International Law* 8.
[28] *World Trade Organisation* 1998 *WT/WGTCP/2* para 86.

Although there are differences between trade policy and competition policy, it is accepted that they share similar goals, are interdependent and often overlap.[29] Arguably, the protection of consumer welfare and economic efficiency requires that free trade be protected through the creation of an open market that is free from entry barriers.[30] Therefore, both policies broadly aim to make domestic markets more competitive to achieve an efficient allocation of resources and, in turn, consumer welfare.[31] Both policies advocate for open markets and free trade, but through different perspectives: trade policy protects the ability of producers to enter the market, while competition policy seeks to curtail measures that impede on consumer welfare.[32]

In their pursuit of these broad objectives, trade and competition policy intersect because they pursue greater market access.[33] The concept of market access may be understood from both a competition law and trade law perspective. From a competition perspective, market access refers to the ability of firms to enter into a market to trade their goods or services.[34] Consequently, the concept of market access is concerned with the elimination of the conduct of private firms that prevents new competitors, whether foreign or domestic, from entering the market to compete.[35] Such conduct or behaviour includes the formation of cartels, abuse of a firm's dominant position and vertical restraints such as refusals to deal.[36]

From a trade perspective, market access refers to the totality of government regulations that affect a product's ability to enter into a country without facing discriminatory treatment.[37] Therefore, trade policy focuses on government measures that may prevent foreign competitors' goods from entering into a country's domestic market. To achieve this,

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[29] F Weiss "From World Trade Law to World Competition Law" (1999) 23 *Fordham International Law Journal* 250 at 256; B Ikejiaku and C Dayao "Competition Law as an Instrument of Protection Policy: Comparative Analysis of the EU and US" (2021) 36 *Utrecht Journal of International and European Law* 75 at 80.

[30] Chang *2004 Georgetown Journal of International Law* 6; *World Trade Organisation* 1998 *WT/WGTCP/2* para 23; EP Motta & AC Murra "International Trade and Competition Policy: Working Together for the Global Economy" in CA Primo Braga (ed) & B Hoekman (ed) *Future of the Global Trade Order* 2ed (2017) 248.

[31] *World Trade Organisation* 1998 WT/WGTCP/2 para 22; W Denner *The Possible Interaction Between Competition and Anti-Dumping Policy Suitable for the Southern African Customs Union (SACU)* (Master of Commerce Thesis, Stellenbosch University, 2013) 25.

[32] Chang *2004 Georgetown Journal of International Law* 6; Dabbah *Comparative Competition Law* 594-595; C Lee & Y Fukunaga "Competition Policy Challenges of Single Market and Production Base" 2013 *ERIA Discussion Paper Series* 1 at 12.

[33] Dabbah *Comparative Competition Law* 579; Weiss 1999 Fordham *International Law* Journal 256.

[34] Dabbah *Comparative Competition Law* 582.

[35] EM Fox "Towards World Antitrust and Market Access" (1997) 91 *The American Journal of International Law* 1 at 19-23.

[36] *Ibid.*

[37] Dabbah *Comparative Competition Law* 583.

multilateral trade agreements such as the Marrakesh Agreement impose obligations on signatories to enhance market access.[38] Notably, such agreements usually restrict countries' ability to design and adopt development strategies that are inconsistent with their commitments to make their markets more accessible.[39]

An example of such restrictions is the national treatment principle, which requires that countries must not apply taxes or other charges to imported goods in a manner that protects domestic production against competition.[40] It has been held that the purpose of this principle is to maintain a competitive relationship between domestic products and imported products.[41] Essentially, provisions which regulate the use of trade-restrictive measures by member states seek to establish or maintain conditions of competition.[42] From both the competition and trade perspectives, the concept of market access is concerned with eliminating conduct that prevents companies from entering into a country's domestic market to compete.[43]

Provisions relating to market access are concerned explicitly with conduct that hinders such market access. These hindrances are also known as barriers to entry and may be defined widely and restrictively. In the restrictive sense, it exists where a firm that seeks to enter into a market is faced with higher costs of doing business than those that apply to firms which are already in the market.[44] In the broad sense, a barrier to entry refers to "anything that makes it difficult for a firm to enter a market".[45]

5.3.3 The shortfalls of competition and trade law in regulating the anti-competitive effects of government subsidies

The second chapter covered how subsidies constitute public restraints on competition on the basis that the restraints are a result of government conduct.[46] The chapter further investigated

[38] KC Shadlen "Exchanging Development for Market Access? Deep Integration and Industrial Policy Under Multilateral and Regional-Bilateral Trade Agreements" (2005) 12 *Review of International Political Economy* 750 at 752.
[39] Shadlen 2005 *Review of International Political Economy* 754.
[40] This principle is contained in Article III:2 of the GATT and Article 5 of the AfCFTA Agreement.
[41] GATT Panel Report, *United States – Section 337 of the Tariff Act of 1930* (7 November 1989) L/6439 - 36S/345 para 5.13.
[42] GATT Panel Report, *European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins* (25 January 1990) L/6627 - 37S/86 para 150.
[43] Dabbah *Comparative Competition Law* 582; Weiss 1999 *Fordham International Law Journal* 256; C Bartók & S Miroudot "The Interaction Amongst Trade, Investment and Competition Policies" 2008 *OECD Trade Policy Papers No. 60* 1 at 4.
[44] Dabbah *Comparative Competition Law* 583.
[45] *Ibid.*
[46] See paragraph 2.3.3 above.

how these public restraints may form the basis on which private firms engage in anti-competitive behaviour. Arguably, then, subsidisation represents one of the cases where it is not easy to apportion responsibility for the restraint between a private firm and the government.[47] Therefore, in such cases, the restraints that hinder market access are known as 'hybrid' or 'mixed' restraints because both private firms and the government cause them.[48] Consequently, responsibility for hybrid restraints is attached to both the firm and the government.

When a restraint on market access is hybrid, the anti-competitive conduct or transaction of a private firm hinders market access because the actions of a government facilitate it.[49] Such restraint is often not dealt with effectively under countries' domestic competition policies. Domestic competition law is ineffective for two reasons. Firstly, national laws are often not adapted to deal with government conduct that has anticompetitive effects on the market.[50] It is argued that the conduct of private firms that gives rise to monopolistic discriminations and the exclusion of competitors is often the result of issues such as the inadequacy of national law in dealing with hybrid restraints.[51]

Secondly, states grant exemptions and immunities for anti-competitive behaviour such as the formation of export cartels or other vertical restraints such as refusals to deal. These exemptions and immunities have a devastating effect on national authorities' ability to deal with hybrid restraints.[52] Consequently, the result is the lack of enforcement of competition law in a manner that legitimises anti-competitive conduct facilitated by the state.[53] This is evidenced by the fact that the formation of export cartels is not prohibited by the national competition laws of most nations.[54]

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[47] Dabbah *Comparative Competition Law* 584.
[48] *Ibid.*
[49] Dabbah *Comparative Competition Law* 588.
[50] CM Gastle "The Convergence of International Trade and Competition Law Through a WTO Market Access Code" (1999) 8 *Currents: International Trade Law Journal* 3 at 6.
[51] *Ibid.*
[52] Fox 1997 *The American Journal of International Law* 16.
[53] EM Fox "Competition Law and the Millennium Round" (1999) 2 *Journal of International Economic Law* 665 at 675. Fox makes the argument that nations tend to resist initiatives to ban export cartels on the basis that they are exercising their sovereignty. The claim of sovereignty lends legitimacy to the establishment of the cartel, even though the effects thereof are inherently anti-competitive.
[54] EM Fox "Competition and World Markets: Law and Economics" 1983 *New York University Journal of International Law and Politics* 299 at 307.

Trade law is better at catching hybrid restraints for two reasons. As discussed above, the international focus of trade law means that the relationship between states can be regulated to avoid anti-competitive effects that result from states' conduct.[55] Secondly, there is a growing recognition in the international community that there are times where the anti-competitive behaviour of private firms is a consequence of governments' prior conduct.[56] Therefore, trade law is relatively more suited to catch state conduct which facilitates anti-competitive behaviour in the market.

However, hybrid restraints have not been addressed consistently and adequately by forums such as the WTO thus far. This is evidenced by the differing conclusions reached by the WTO Dispute Settlement Body in disputes where issues of competition policy arose. One of these disputes was the *Mexico – Telecoms* dispute.[57] Before 1997, long-distance and international telecommunications were provided exclusively by a company called Telmex, which used to be state-owned.[58] After 1997, Telmex was privatised, and the Mexican government subsequently authorised multiple companies to provide international services on their networks. To offer outgoing calls to another country, a long-distance carrier had to connect to a carrier that operates in the target country.[59] This means that Mexican carriers that want to offer long-distance calls into the US must connect to firms that operate in the US. Mexico's laws provided that the largest carrier of outgoing calls to a particular international market had the exclusive right to negotiate terms for the termination of calls. Such terms would not only apply to that carrier, but also other carriers between Mexico and the market in question.[60] At the time of the dispute, Telmex was the largest carrier of outgoing calls for all markets.

Consequently, Telmex had the exclusive right to determine the price that foreign firms had to pay to terminate calls in Mexico, which meant that Telmex's competitors could not charge

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[55] See paragraph 5.3.1 above.

[56] Dabbah *Comparative Competition Law* 589; RD Anderson, WE Kovacic, AC Müller & Nadezhda Sporysheva "Competition Policy, Trade and the Global Economy: Existing WTO Elements, Commitments in Regional Trade Agreements, Current Challenges and Issues for Reflection" 2018 *World Trade Organisation Staff Working Paper ERSD-2018-12* 1 at 36.

[57] Panel Report, *Mexico – Measures Affecting Telecommunications Services* (2 April 2004) WT/DS204/R.

[58] PR, *Mexico – Telecoms* para 2.2.

[59] DJ Neven & PC Mavroidis "*Mexico – Measures Affecting Telecommunications Services* (WT/DS204/R) A Comment on "El Mess in Telmex"" (2006) 5 *World Trade Review* 188 at 190.

[60] PR, *Mexico – Telecoms* para 2.2. Call termination is the service of terminating a phone call, fax or other telecommunication to the party that is being called. See International Telecommunications Union "Trade in Telecommunications: A Glossary of Technical Terms" https://www.itu.int/newsarchive/press/WTPF98/Glossarytechnterms.html (Accessed 10 October 2020).

prices that were less than the price set by Telmex.[61] This represents a case of hybrid restraints to market access, in that the government's conduct facilitates the anti-competitive effects on the market.[62] For this reason, the US requested that the panel find that Mexico's measures are anti-competitive because they had effects which included the creation of a cartel operated by Telmex as well as excessive pricing.[63]

The panel concluded that Mexico had failed to comply with its obligations under the GATS to maintain appropriate measures to prevent anti-competitive conduct, mainly because it implemented measures that facilitated anti-competitive conduct in its markets.[64] This ruling is important because it was the first time that the WTO explicitly dealt with an issue relating to competition law. Moreover, the ruling illustrates the understanding discussed above that hybrid restraints on market access are becoming as essential to deal with as conduct which purely involves state action.

The decision in *Mexico – Telecoms* has, unfortunately, not led to an interpretation of other WTO obligations in a manner that explicitly deals with anti-competitive conduct. A few months after this ruling, the WTO Appellate Body held that the provisions in Article XVII: 1 of the GATT are meant to prevent certain types of discriminatory behaviour.[65] As a result, the Appellate Body saw no need to interpret the provisions "as imposing competition-law-type obligations".[66] Arguably, this illustrates a reluctance by the WTO to interpret trade law provisions as imposing obligations relating to competition where the provisions in question do not explicitly provide for this.[67]

The discussion in this section reveals some essential lessons for the AfCFTA. It is argued that while trade law is better at regulating the behaviour of states, there is a reluctance to interpret

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[61] EM Fox "The WTO's First Antitrust Case – Mexican Telecoms: Modest World Antitrust" (2006) 21 *Antitrust* 74 at 74.

[62] This was exacerbated by the fact that long-distance carriers could not be controlled by foreign firms, as Mexican law restricted ownership of a carrier by a foreign firm to just a 49 percent share. This means that US firms could not control carriers in Mexico to increase competition to incumbent firms. See Neven and Mavroidis 2006 *World Trade Review* 190.

[63] PR, *Mexico – Telecoms* para 3.1; Fox 2006 *Antitrust* 74.

[64] PR, *Mexico – Telecoms* para 8.1.

[65] Appellate Body Report, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain* (30 August 2004) WT/DS276/AB/R para 145.

[66] *Ibid.*

[67] This is exacerbated by the fact that the WTO does not have any explicit rules which deal with competition issues. See H Andersen "Technology Promotion in WTO Law: The Discrepancy between Trade, IP Protection, and Competition Law? – The Case with EU's Antidumping Policies" (2020) *Copenhagen Business School Law: Research paper Series No. 20-04* 1 at 3.

trade provisions as imposing competition-type obligations. This may make it difficult to effectively regulate situations where anti-competitive behaviour is a consequence of the state's conduct. However, this is unlikely to be a problem as much as it is in the WTO because a competition policy is being developed in the AfCFTA. Consequently, AfCFTA members will not have to rely on trade law provisions when the nature of the dispute concerns anti-competitive behaviour.

Additionally, the discussion shows that there is currently little understanding in the international community about what constitutes legitimate reasons to limit trade.[68] The prohibition on export and local content subsidies is an example of this. There is an understanding that there may be instances where this kind of subsidisation is a useful policy tool. However, the absolute prohibition of such subsidies, with severely limited policy space for developing countries, indicates that there has not been sufficient conceptualisation about how the pro-competitive effects of such subsidies may be realised in global markets. The next section explores how this may be done in the AfCFTA.

5.4 Developing a market access principle as the foundation for the regulation of prohibited subsidies

5.4.1 The need to treat prohibited subsidies as an issue of competition law

There is a recognition that trade regimes need to be complemented by good competition law regimes if the benefits of trade liberalisation are to be realised to their full extent and protected.[69] Competition laws can play an essential role in sustaining the economic growth and development achieved by regulatory reform and trade liberalisation. They achieve this by guarding against anti-competitive behaviour that detriments consumer welfare.[70] The fact that the AfCFTA Agreement provides for the establishment of competition policy is evidence of such a recognition.[71] Therefore, the question addressed in this section is why the AfCFTA's competition policy must treat prohibited subsidisation as a competition issue.

[68] EM Fox "Antitrust and Regulatory Federalism: Races Up, Down, and Sideways" (2000) 75 *New York University Law Review* 1781 at 1804.
[69] IG Bercero & SD Amarasinha "Moving the Trade and Competition Debate Forward" 2001 *Journal of International Economic Law* 481 at 489.
[70] Bercero & Amarasinha 2001 *Journal of International Economic Law* 489. EM Fox "Competition Policy: The Comparative Advantage of Developing Countries" (2016) 79 *Law and Contemporary Problems* 69 at 80-82.
[71] See paragraph 1.2 above.

The discussion in the previous section highlights that the concern with trade law is not whether it can be used to deal with questions related to competition, but rather whether the framework through which it is done will be coherent and whether it can be done effectively.[72] Conversely, there is doubt about whether countries' competition laws are equipped to deal with anti-competitive government practices. The reason for this is that it is the government tasked with enforcing competition laws that ends up encouraging anti-competitive behaviour in the markets. It does so through mechanisms such as exemptions from competition legislation.

Arguably, the consequence of globalisation is that countries face the challenge of dealing with anti-competitive practices that originate in different jurisdictions to the ones in which the effects thereof are being experienced.[73] This is the case where there is transboundary abuse of dominance by a firm.[74] For instance, export subsidies, which are discussed above,[75] may result in a firm's dominance in a foreign country as well as the subsequent abuse of such dominance. In such a case, the abuse of the dominant position originates from the subsidising state, but the effects thereof are experienced in another state.

Prohibited subsidies are industrial tools that aim to strengthen particular firms in countries' markets that can compete at an international level.[76] They raise rivals' costs of entry in the case of new competitors, or the costs of production in cases of incumbent competitors. Consequently, this shapes the nature of opportunities available to subsidised firms.[77] For example, this may allow for subsidised companies to innovate without raising the costs that the subsidised companies incur. Shaping the nature of opportunities available in the market for subsidised firms hinders the process of competition significantly because it means that firms that are not eligible for government subsidies are unable to compete.[78]

Arguably, prohibited subsidisation is not radically different from other measures that governments often use to support domestic firms and industries in their efforts to respond to globalisation and increase their overall competitiveness. The policies implemented by

[72] PB Potter & L Biukovic *Globalisation and Local Adaptation in International Trade Law* (2011) 23.
[73] Bercero & Amarasinha 2001 *Journal of International Economic Law* 483; T Phan "Realism and International Cooperation in Competition Law" (2017) 40 *Houston Journal of International Law* 297 at 298.
[74] Bercero & Amarasinha 2001 *Journal of International Economic Law* 483.
[75] See paragraph 2.3.3.2 above.
[76] AS Papadopoulos *The International Dimension of EU Competition Law and Policy* (2010) 46.
[77] I Lianos and DD Sokol *The Global Limits of Competition Law* (2012) 91.
[78] The effects of subsidies on competition are discussed in more depth in paragraph 2.3 above.

governments to promote rapid industrialisation and development may inhibit not only the development of competition law, but also the process of competition entirely.[79] Examples of such policies may include exemptions from competition law and even the use of export subsidies by countries that meet the criteria for the application of the special and differential provisions in the WTO.

It is argued that in the case of the use of export subsidies by developing countries that qualify for protection under special and differential provisions, such an exemption would not exist in the absence of recognition that competition within the relevant market has been hindered. This is a recognition that export subsidisation is a risk because of its potential impact on the competitiveness of international markets.[80] However, there is simultaneously an acceptance that such a response to globalisation may benefit domestic producers in the subsidising states.[81]

Arguably, the question should not be whether local content and export subsidies affect trade and competition. Such subsidisation is a competition-related practice by a government that has the effect of influencing international trade.[82] This is evidenced by the fact that the reason for their prohibition is that they have trade-distorting and, therefore, anti-competitive effects.[83] Instead, the question is what is the most effective way to counter the anti-competitive effects of such subsidies while maintaining the benefits that they may provide to countries' domestic industries.

The focus of studies advocating for the establishment of supranational competition regimes has focused on the need to prevent cross-border anti-competitive conduct. Arguably, a supranational competition regime may enhance the international competitiveness of AfCFTA member states in several ways. Firstly, competition policy assists in eliminating practices that affect market access for imported products by disciplining firms whose practices make new entrants vulnerable to practices that hinder their market access.[84] However, competition policy may play an essential role in the AfCFTA in determining practices by states that are pro-competitive.

[79] DJ Gerber *Global Competition: Law, Markets and Globalization* (2010) 83.
[80] *Ibid.*
[81] *Ibid.*
[82] *Ibid.*
[83] Prohibited subsidies are discussed in paragraphs 3.2.3 and 4.3.2 above.
[84] Bercero & Amarasinha 2001 *Journal of International Economic Law* 490.

One of the effects of deindustrialisation in the African continent,[85] is that the majority of states in the continent depend on imported goods. This is a result of the underdevelopment of their industrial sectors.[86] This lack of industrial development is further highlighted by the fact that the majority of imports are intermediate goods used in the manufacture of final goods by producers.[87] Arguably, the subsidisation of local industries may help establish essential industries in developing countries. Furthermore, competition law may aid this process by distinguishing between subsidies that are pro-competitive in doing so, and those that substantially lessen competition in the market.

Secondly, there is an acceptance that the use of prohibited subsidies is meant to affect trade between countries. However, the ability of developing countries to use export subsidies in certain conditions is evidence of a recognition that in developing countries, export subsidisation may be beneficial to consumers. Arguably, competition policy that examines the specific effects of a subsidy in a market allows for more effective regulation. With the implementation of competition policy, authorities will be able to analyse conduct based on whether it harms competition in the market and not whether a developing country is using the subsidy.

Ultimately, it is argued that considering prohibited subsidies as public restraints on competition has two consequences. Firstly, and specifically in the case of export subsidies, it allows for AfCFTA authorities to expand countries' policy space, while effectively capturing conduct that has adverse effects on markets of a given country.[88] This is important because one of the essential reasons that intra-African trade is low is that the costs of trading within the continent are high. This allows governments to stimulate exports where this is found to be pro-competitive in the market of the target country.[89]

Secondly, it is argued that competition policy allows for a more in-depth examination of the effect of a subsidy in the relevant market to determine its effects. This is similar to the way

[85] Deindustrialisation is discussed in paragraph 2.3.2 above.
[86] Bercero & Amarasinha 2001 *Journal of International Economic Law* 489.
[87] Bercero & Amarasinha 2001 *Journal of International Economic Law* 490; United Nations Conference on Trade and Development (2019) 114; Africa Export-Import Bank "African Trade Report 2019: African Trade in a Digital World" 2019 4 at 15.
[88] Bercero & Amarasinha 2001 *Journal of International Economic Law* 490.
[89] This allows the protection of competition to remain paramount and to allow anti-competitive intervention only where a country's industrial and social development objectives necessitate it. See DD Sokol *et al Competition Law and Development* (2013) 220.

that actionable subsidies are dealt with in the WTO. Furthermore, bringing prohibited subsidisation under competition law ensures that states' inherent right to regulate trade is maximised and limited only where the effect of the subsidy is to hinder market access.[90] Ultimately, it is argued that the consequence of this will be to expand the range of policy tools that states have at their disposal. Furthermore, this will enable them to pursue essential policy priorities without limitation.[91]

5.4.2 The principle of market access as the foundation for disciplining prohibited subsidies

The discussion in the previous section highlights that international trade law is not fully equipped to deal with the effects of prohibited subsidisation on competition in the relevant market because it prohibits such subsidisation absolutely, without exception. Furthermore, the section highlights that hindrances to market access are hybrid problems that may consist of both private and public restraint. In the case of hindrances caused by prohibited subsidies, neither trade nor competition law is fully equipped to deal with them.[92] A market access principle that forms the foundation for the regulation of prohibited subsidies must take into account both the trade and competition dimensions thereof.

A market access principle may be founded on an obligation for AfCFTA members not to block market access, which will not only provide a foundation for dispute settlement but will further provide a benchmark for the evaluation of prohibited subsidies.[93] However, the fact that prohibited subsidies affect both trade and competition raises the question as to whether such a principle must be trade-based or competition-based.[94] It is argued that the basis of

[90] The argument has previously been made, although in relation to South African Competition law, that competition authorities are not well placed to use their standing to deal with public restraints. This argument can be made generally in light of the international community that individual experiences of countries in multilateral agreements gives competition authorities in those regions the standing to tackle public restraints. See Sokol *et al Competition Law and Development* 219.

[91] Sokol *et al Competition Law and Development* 219. Arguably, this may go a long way in levelling the playing field and reducing the inequality between wealthier nations such as South Africa, Egypt and Nigeria and the rest of the African continent. See CM Nwankwo & CC Ajibo "Liberalising Regional Trade Regimes Through AfCFTA: Challenges and opportunities" (2020) 64 *Journal of African Law* 297 at 308.

[92] Gastle 1999 *Currents: International Trade Law Journal* 10; K Anderson and E Valenzuela "What Impact are Subsidies and Trade Barriers Abroad Having on Australasian and Brazilian Agriculture" (2021) *Australasian Journal of Agricultural and Resource Economics* 1 at 1-2.

[93] Gastle 1999 *Currents: International Trade Law Journal* 7. Market Access not only allows firms to go into international markets, it enables them to access more affordable factors of production and gives them access to new and better technology. See CA Lobo *et al* "Factors Affecting SMEs' Strategic Decisions to Approach International Markets" (2020) 14 *European Journal of International Management* 617 at 622-623.

[94] It is undeniable that free trade can improve firms' market access, thereby increasing competition and efficiency. SAR Khan *et al* "Investigating the Effects of Renewable Energy on International Trade and

such a principle has implications for how effective it will be in regulating prohibited subsidies and its responsiveness to the concerns of both trade and competition commentators.

5.4.2.1 A trade-based market access principle

A trade-based market access principle operates in the same manner as the current Guidelines,[95] and prohibits subsidies contingent on export or local content requirements without the need to evaluate their effects on the relevant market. In the third chapter, it was highlighted that regulating prohibited subsidies this way is ineffective because it ignores scenarios where prohibited subsidisation may be pro-competitive.[96] In extension, it is argued that the way prohibited subsidies are regulated is contradictory to the aim of subsidies disciplines to limit government interventions that distort trade.

In the context of subsidisation, a trade-based market access principle will only serve to mirror the status quo because it changes nothing about the way prohibited subsidies are regulated. Such a regime would involve an undertaking by member states in the AfCFTA not to permit private restraints to trade, which are carried out by businesses on their own or with the collaboration of the government, to undermine their market access commitments.[97] In such a case, liability for a state that breaches its commitments would be strict. Consequently, the effects of the measure on the relevant market would not need to be analysed in order to prohibit that measure.[98]

The determination of whether a measure is a subsidy involves a determination of whether, by standards established in the relevant market, a financial contribution confers a benefit on a firm.[99] Furthermore, subsidies other than those that are prohibited are treated according to the effects that they have on the relevant market. On the other hand, local content and export subsidies are prohibited purely based on contingency, regardless of the effect that they have on markets. Arguably, it is a contradiction to prohibit subsidisation on the basis that it severely distorts trade, without analysing whether the distortion of trade has occurred. Therefore, a trade-based market access principle will only preserve the status quo.

Environmental Quality" (2020) *Journal of Environmental Management* 1 at 3 illustrate this in respect of the renewable energy sector. However, this in this study, the question of the basis for a market access principle is meant to address the different results that an emphasis on either competition or international trade will yield.

[95] The AfCFTA Guidelines on the Implementation of Trade Remedies.

[96] See paragraph 3.2.3 above.

[97] B Sweeney "Globalisation of Competition Law and Policy: Some Aspects of the Interface between Trade and Competition" (2004) 5 *Melbourne Journal of International Law* 375 at 424.

[98] *Ibid.*

[99] The requirements for a subsidy are discussed in chapters 3 and 4.

5.4.2.2 A competition-based market access principle

A competition-based market access principle is likely to protect consumer welfare in the market and promote the process of competition. AfCFTA member states would be required to undertake not to cause substantial and unjustified market blockage by anticompetitive means, resulting in a breach of their market access commitments.[100] In light of promoting the process of competition, the principle seeks to promote rivalry amongst firms in the market, thereby paying attention to the competitive process.[101] This is significant because local content subsidies specifically alter the conditions of competition between firms in the market by conferring a benefit that precludes the recipients from having to innovate and improve.

However, the focus on promoting rivalry in the market must be balanced against ensuring that such rivalry enhances consumer welfare. In such a case, authorities would focus on whether subsidisation results in pricing that diminishes consumer welfare in the relevant market.[102] Such an effect is not limited to subsidies that result in higher prices of goods in the market, but also those that drive prices so low as to drive away competitors from the market. The focus on consumer welfare allows for a determination of whether consumers can "... successfully engage with and participate in the market".[103]

The focus on consumer welfare is vital because it ensures that the use of prohibited subsidisation does not deny the consumer the ability to engage in the market or encourages them to make a detrimental choice due to a lack of competitors in the market.[104] Arguably, such an approach takes advantage of the convergence of competition law and international trade by evaluating the impact of trade policies on consumer welfare in the relevant market. Moreover, this approach not only promotes competition and protects consumer welfare, but

[100] Fox 1997 *The American Journal of International Law* 23; Gastle 1999 *Currents: International Trade Law Journal* 6. This is important because firms invest in innovation and productivity so they can maximise the benefits of easier access to international markets. See A Peluffo, I Martinez-Zarzoso & E Silva "New Stuff or Better Ways: What Matters to Access International Markets?" (2020) 23 *Journal of Applied Economics* 656 at 660.
[101] Sweeney 2004 *Melbourne Journal of International Law* 423.
[102] Sweeney 2004 *Melbourne Journal of International Law* 422.
[103] RB Leary & G Ridinger "Denial Without Determination: The Impact of Systematic Market Access Denial on Consumer Power and Market Engagement" (2020) 39 *Journal of Public Policy and Marketing* 99 at 101.
[104] Leary & Ridinger 2020 *Journal of Public Policy and Marketing* 99.

also address the market access concerns that are likely to be raised by allowing for the use of prohibited subsidies in the AfCFTA.[105]

5.5 The European Union's state aid rules: lessons for the AfCFTA

In the EU, subsidies are referred to as state aid and are governed by the Treaty on the Functioning of the European Union (TFEU). Article 107(1) of the TFEU states that:

> "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."

For a measure to constitute state aid according to Article 107(1), it must satisfy the following requirements: (a) it must be granted in any form whatsoever by the state, or through the state's resources; (b) it must distort or threaten to distort competition by favouring certain undertakings or the production of certain goods, and; (c) it must affect trade between members of the EU. Unless a measure satisfies these requirements, it does not constitute state aid. Although it is worded differently, the definition of state aid is similar to that of a subsidy insofar as it requires that there must be a government contribution that confers a benefit on the recipient and the eligibility to receive the contribution is limited to certain enterprises or industries.

Explicitly recognising state aid as a competition issue is arguably due to the acceptance that even though restricting private anti-competitive practices is central to maintaining competition, this, by itself, is not sufficient to create a level playing field.[106] State aid also needs to be regulated because it creates distortions that result from giving state resources to enterprises that fail to compete effectively in the market.[107] It is argued that the control of

[105] Križić argues that rules on competition policy may be necessary because anti-competitive restraints have the potential to undermine the benefits of trade liberalisation and restrict market access. Subsidies are one of the measures that may facilitate such anti-competitive restraints. Arguably, market access concerns necessitate rules that subject subsidies to competition frameworks. See I Križić "The International Regulation of Competition Policy and Government Procurement: Exploring the Boundaries of the Trade Regime" (2020) *New Political Economy* 1 at 3.

[106] H Kassim & B Lyons "The New Political Economy of EU State Aid Policy" (2013) 13 *Journal of Industry, Competition and Trade* 1 at 5.

[107] Kassim & Lyons 2013 *Journal of Industry, Competition and Trade* 5; P Willis *Introduction to EU Competition Law* (2013) 203.

state aid regulates competition among EU member states, which occurs through the practice of states giving resources to companies.[108] Therefore, it prevents states from circumventing rules relating to private anti-competitive conduct by stepping in to assist businesses.[109]

Two things are essential to note about the EU's state aid rules. Firstly, the language of the EU state aid rules is more explicit than that of the WTO and the AfCFTA Agreement about the intention to prevent anti-competitive practices in the EU common market. This is evidenced by the fact that one of the definitional elements in Article 107(1) is that there must be a distortion or a threat of distortion of competition in the market. This element ensures that aid only falls under the provisions of the TFEU where it strengthens the position of a select few firms relative to those firms' competitors in the market.[110]

Furthermore, the requirement of distortion of competition and that such aid must affect trade has been interpreted in a manner that pays attention to the competitive strength of the recipient, even without the need to delineate the relevant market.[111] What matters in the examination of whether a firm has benefitted from aid is whether its competitive strength, relative to other actors in the market, has improved as a result of the aid.[112] For instance, this may be the case where aid relieves a firm from incurring the costs of increasing its production capacity, costs that it would otherwise pay in full but for the aid.[113] To the extent that this strengthens the recipient's competitive position, trade is presumed to be affected and competition distorted.[114]

Secondly, unlike the WTO, state aid rules do not recognise differences between actionable and prohibited subsidies. This is because when a measure meets the requirements of Article 107(1), it is prohibited as it is inconsistent with the TFEU. The result is that the default

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[108] J Haucup & U Schwalbe "Economic Principles of State Aid Control" 2011 *DICE Discussion Paper No. 17* 1 at 14.

[109] *Ibid.*

[110] Willis *Introduction to EU Competition Law* 205.

[111] F de Cecco *State Aid and the European Economic Constitution* (2013) 55.

[112] *Ibid.* This aligns with the European Commission's goal to prevent distortion of the EU internal market. See R Van Druenen & P Zwaan "Distorted Promotion of Undistorted Competition? Commission Decisions after Formal Investigations in the EU State Aid Regime" (2021) *Journal of European Policy* 1 at 6.

[113] F de Cecco *State Aid and the European Economic Constitution* (2013) 55.

[114] However, it must be noted that some distortion of competition is likely to occur as a consequence of subsidisation because the subsidy leaves the recipient in a better position in the relevant market. Therefore, it is argued that the State Aid rules require that a balancing exercise be undertaken to determine whether the harmful effects of the aid are mitigated or avoided to achieve the intended outcome. See M Bourreau, R Feasey & A Nicolle "Assessing Fifteen Years of State Aid for Broadband in the European Union: A Quantitative Analysis" (2020) 44 *Telecommunications Policy* 1 at 2.

position in the EU is that state aid is prohibited. However, such prohibition is not absolute because the European Commission must authorise state aid that falls into Article 107(2). Furthermore, the European Commission has the discretion to allow aid that falls under Article 107(3) of the TFEU.[115] Therefore, Articles 107(2) and 107(3) of the TFEU serve as exceptions to the general prohibition on state aid.[116]

According to Article 107(2) of the TFEU, "the following shall be compatible with the internal market:

a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
b) aid to make good the damage caused by natural disasters or exceptional occurrences;[117]
c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point."

State aid which falls within the ambit of Article 107(2) is granted automatic exemption without the need for the member state implementing the measures to obtain specific authorisation for their use.[118] Arguably, state aid granted in fulfilment of Article 107(2)(b) and (c) is designed for purposes such as the rebuilding of infrastructure and provision of necessities, making them necessary for a state to achieve social objectives. Furthermore, the

[115] C Ehlermann & M Goyette "The Interface Between EU State Aid Control and the WTO Disciplines on Subsidies" (2006) 5 *European State Aid Law Quarterly* 695 at 705. See C Banet "Legal Status and Legal Effects of the Comission's State Aid Guidelines: The Case of the Guidelines on State Aid for Environmental Protection and Energy (EEAG) (2014-2020)" (2020) *European State Aid Law Quarterly* 172 at 174.

[116] Some of the considerations involved in determining whether the measure may be exempted include without limitation (i) the involvement of state resources; (ii) the extent to which a firm receiving aid receives an economic advantage; and (ii) any alteration of market conditions which may occur. See Bourreau *et al* 2020 *Telecommunications Policy* 4.

[117] For instance, the European Commission granted automatic exemption to state aid which targeted industries that were crisis-stricken because of the COVID-19 pandemic. This included state aid meant to fund R&D necessary to tackle the pandemic. See S Meunier & J Mickus "Sizing Up the Competition: Explaining Reform of European Union Competition Policy in the COVID-19 Era" (2020) 42 *Journal of European Integration* 1077 at 1079.

[118] Willis *Introduction to EU Competition Law* 205.

reason that state aid which falls within 107(2)(a) is automatically exempted is that the definition of state aid requires that the aid be granted to certain undertakings. Therefore, aid to consumers would not constitute state aid that distorts trade in the market place.

According to Article 107(3) of the TFEU, "the following may be considered to be compatible with the internal market:

a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic, and social situation;
b) 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;
c) 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;
d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;
e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission."

The majority of the measures exempted in Article 107(3) are economical in that state aid geared towards their pursuit aim to address considerations of economic policy.[119] However, such considerations, such as underemployment and economic development, are socio-economic and are not based on achieving economic efficiency or consumer welfare in the markets. [120] This means that EU state aid rules expressly recognise non-competition objectives that are pursued by member states. Moreover, the exemptions require that state aid must target interests that are common to the European Community, and not national interests.[121] In addition, the measure must be necessary to achieve such an interest.[122]

[119] De Cecco *State Aid and the European Economic Constitution* 71.
[120] *Ibid.*
[121] Willis *Introduction to EU Competition Law* 206.
[122] *Ibid.*

The AfCFTA can draw essential lessons from the substantive rules in Article 107(2) and (3) by the AfCFTA. Firstly, a general prohibition, with limited grounds upon which subsidisation may be justified, would allow for the restriction of government intervention in the market.[123] Consequently, this would leave room for the use of subsidisation in circumstances where it is necessary. [124] Moreover, it is argued that the grounds listed in Article 107(3) better encapsulate the reasons that governments are likely to use subsidisation when compared to the general exceptions listed in Article 25 of the AfCFTA Protocol on Goods.[125]

It is equally important to note the discretion granted to the European Commission in Article 107(3)(e) to take into consideration grounds for justification that may not fall into the list of grounds that have been outlined, but that nonetheless serve significant objectives. Arguably, such discretion ensures that the granting of state aid is viewed in proper context, and not with regard only to Article 107(3)(a)-(d). Therefore, this ensures that state aid not only serves a legitimate objective, but one that is common to all the EU member states.

Consequently, state aid rules ensure that even when a member state uses state aid to pursue legitimate policy objectives, such aid is beneficial to the EU, and not just to the individual member using it. The lesson in this respect is that it is not impossible to design a regime in the AfCFTA for the regulation of prohibited subsidies wherein it is possible to justify their use. Furthermore, such a regime is likely to be successful if it is established to ensure that the subsidisation serves to enhance competition and consumer welfare in markets by pursuing interests that are common to all, if not most, AfCFTA member states.

Secondly, the EU's state aid rules are more stringent than the subsidy rules contained in the WTO's SCM Agreement insofar as the former generally prohibits all subsidisation subject to a member state proving that its measure qualifies for exemption. However, the lack of

[123] Article 108(3) of the TFEU requires EU member states to notify the European Commission of any plans to grant state aid. This provision allows the European Commission to assess the proposed state aid and for other EU member states to make comments on such proposed aid. Consequently, government intervention is carefully controlled by assessing the effects of a members' conduct prior to it taking place, rather than after, when injury to other members' interests has already occurred.

[124] For instance, there are cases where the European Commission has decided not to raise objections to countries' decision to provide state aid which pursued objectives such as regional development, increasing employment, and development of specific sectors of the economy. See, for example, State Aid, SA. 37121 (2013/N) – *Spain – Start-up Aid to Airlines Operating from the Canary Islands* (OJ C 348/1, 9 April 2014); State Aid, SA. 36929 (2013/N) – *Germany – Notification of a Rescue and Restructuring Guarantee Scheme in the Land Hesse* (OJ C 348/1, 6 November 2013); and State Aid, SA. 38240 (2014/N) – *Sweden – Shipping Aid (Sjöfartsstöd)* (OJ C 348/1, 24 March 2014).

[125] The general exceptions in Article 25 are listed and discussed in paragraph 3.3.1.2 above.

distinction between different kinds of state aid allows the EU to afford the same treatment to all aid based on their effects on the common market, and not the type of aid being granted. Therefore, such an approach allows aid to be assessed on its merits, taking into account whether it serves the EU's interests.

Arguably, the lesson for the AfCFTA in this respect lies in the fact that it is possible to adopt measures in the AfCFTA which regulate subsidies in a manner more suited for the developmental needs of the continent. It is possible to adopt a regime that is different from that of the WTO, which applies globally. Furthermore, it is beneficial when such a regime is meant to enhance the benefits of liberalised trade in a free trade area. Ultimately, it is argued that the AfCFTA must consider adopting a competition-based regime for the regulation of prohibited subsidies. Such an approach is likely to assist in addressing issues of deindustrialisation, while not neglecting the trade concerns brought about by less stringent regulation.

5.6 Conclusion

While it can be argued that an AfCFTA member state might be able to invoke the general exceptions in Article 25 of the Protocol on Goods, this clause is unlikely to be useful for states seeking to use prohibited subsidisation. The reason is that the general exceptions were not drafted to provide justifications for distortions of competition in the market. As a result, it is argued in this chapter that the use of prohibited subsidisation must be treated in the AfCFTA as a competition issue, and not solely a trade issue. This allow for more direct regulation of the effects of prohibited subsidies. Furthermore, it would also give room for AfCFTA member states to justify their use when there are pro-competitive effects.

Furthermore, it is argued that the AfCFTA needs to adopt a regulatory regime based on competition principles, where the use of prohibited subsidies may be allowed based on whether they enhance consumer welfare and overall competition in the AfCFTA. While this would entail diverging from the rules of the SCM Agreement, such divergence is not unprecedented, as is evident from the EU's state aid regime. Therefore, it is argued in this chapter that the effective regulation of prohibited subsidies in the AfCFTA requires member states to treat such subsidisation as an issue involving both trade and competition law. Ultimately, preserving AfCFTA members' policy space requires a change in the way prohibited subsidies are currently perceived and regulated.

Chapter 6: Recommendations and Conclusion

6.1 Introduction

The main question that this thesis sought to answer was whether the provisions of the AfCFTA Agreement effectively regulate the anti-competitive effects of government subsidies in the AfCFTA. The issue of the justification of prohibited subsidies has previously been raised in the context of the WTO's SCM Agreement, albeit in light of subsidies aimed at addressing environmental concerns. This issue has not been addressed authoritatively by the WTO. As a result, the uncertainty which exists in the WTO was inherited in the AfCFTA because the AfCFTA's subsidies disciplines are taken from the SCM Agreement.

This thesis discussed the provisions which regulate the use of prohibited subsidies in the AfCFTA in light of the analysis conducted in earlier chapters about the justifications states employ for the use of subsidisation as well as the effects of subsidies on competition. The thesis further compared the provisions of the AfCFTA which regulate the use of subsidies with those of the WTO to give further context about why the effectiveness of AfCFTA regulations needs to be interrogated. Ultimately, after explaining why there is a gap in the regulation of prohibited subsidies which needs to be addressed, this study sought to determine whether such a gap may be remedied by utilizing competition policy.

This chapter presents the findings and recommendations that arise from the research carried out in this study. The first section sets out a summary of the thesis and highlights the essential conclusions that were drawn in each chapter. The second section provides brief recommendations based on the conclusions that have been drawn throughout this study. The third section makes final remarks and concludes this thesis.

6.2 Summary of thesis and findings

Chapter one provided the background for this study by explaining the problem with how the AfCFTA Agreement regulates prohibited subsidies and the importance of this problem.[1] Specifically, the chapter highlighted that the problems regarding the regulation of prohibited subsidies in the AfCFTA stem from a transplant of the provisions of the SCM Agreement

[1] See paragraph 1.3 of this thesis.

into the AfCFTA Agreement.[2] The provisions of the SCM Agreement prohibit the use of local content and export subsidies without regard to their effects on trade, nor the reasons provided by the WTO member that uses them.[3]

It was argued that an absolute prohibition of local content and export subsidies results in a gap in the WTO legal framework because WTO members that pursue important developmental objectives by using these subsidies cannot do so.[4] Consequently, in light of the absence of an exceptions clause in the SCM Agreement, there has been debate concerning whether Article XX of the GATT may be used to exempt the use of prohibited subsidies that pursues members' developmental objectives.[5]

This chapter argued that because the AfCFTA Agreement's provisions on local content and export subsidies are the same as those in the SCM Agreement, this gap is likely to exist in the AfCFTA as well.[6] Consequently, AfCFTA members that currently use these subsidies and those that intend to use these subsidies would be unable to do so because of the provisions of the AfCFTA Agreement. In light of this problem, the chapter highlighted that this study would critically analyse the AfCFTA Agreement to determine whether it regulates the use of prohibited subsidies effectively.[7] To achieve this goal, the thesis pursued three objectives.

Firstly, this thesis analysed the Protocol on Goods,[8] and the Guidelines,[9] to determine whether the use of prohibited subsidies in the AfCFTA is regulated effectively.[10] In achieving this goal, the thesis embarked on a discussion of why governments in developing countries use subsidies as part of their development strategies.[11] Further, it entailed a discussion of whether, in light of the objectives pursued by these governments, it was useful to prohibit local content and export subsidies without any regard to the justification provided by an AfCFTA member.[12]

[2] See paragraph 1.4 of this thesis.
[3] See paragraph 1.4.1 of this thesis.
[4] *Ibid.*
[5] See paragraph 1.4.2 of this thesis.
[6] See paragraph 1.3.1 of this thesis.
[7] See paragraph 1.7 and chapter 2 of this thesis.
[8] The AfCFTA Protocol on Trade in Goods.
[9] The AfCFTA Guidelines on the Implementation of Trade Remedies.
[10] See paragraph 1.7 of this thesis.
[11] See paragraph 2.3 of this thesis.
[12] See paragraph 3.3 of this thesis.

Secondly, this thesis analysed the gap created by the SCM Agreement's provisions on prohibited subsidies, specifically focusing on how WTO case law has resolved this problem and the debate it has sparked among academics.[13] Mainly, this entailed discussing whether the principles developed in WTO case law and by academics in this area may be applied to resolve the problems created by the AfCFTA Agreement's provisions on prohibited subsidies.[14]

Thirdly, after this study had determined that the use of prohibited subsidies in the AfCFTA was regulated ineffectively, the study analysed whether competition policy may play a role in making such regulation more effective in the future.[15] This entailed a discussion of how local content and export subsidies affect competition between subsidised and unsubsidised firms in the market.[16] Since these subsidies may adversely affect competition, this thesis discussed whether competition law might be better suited to distinguish between the pro-competitive and anti-competitive effects of prohibited subsidies.[17]

Finally, this thesis will present the significant findings drawn from each chapter and make recommendations based on these findings. In this light, this section summarises the findings made in this thesis. Firstly, the discussion of the role and impact of subsidies in the AfCFTA summarises chapter two of this thesis. Secondly, an analysis of prohibited subsidies in the AfCFTA summarises chapter three of this thesis. Thirdly, a discussion of prohibited subsidies in the WTO summarises chapter four of this thesis. Finally, a discussion about effectively regulating the use of prohibited subsidies summarises chapter five of this thesis.

6.2.1 The role and impact of subsidisation in the AfCFTA

Chapter 2 provided the context behind the use of subsidisation as an industrial policy tool and why it is essential to study the use of subsidies in the AfCFTA. The chapter began by differentiating between the two kinds of subsidies, consumer subsidies and producer subsidies, and highlighting the focus of this study on producer subsidies.[18] Essentially, the focus of this study was on producer subsidies that are contingent on the export performance of a producer or its use of local content over domestic content.

[13] See paragraph 1.7 and chapter 4 of this thesis.
[14] This discussion was carried out in paragraph 4.7 of this thesis.
[15] See paragraph 1.7 and chapter 5 of this thesis.
[16] This discussion was carried out in paragraph 5.4.1 of this thesis.
[17] This discussion was carried out in paragraph 5.4.2 of this thesis.
[18] See paragraph 2.2 of this thesis.

Furthermore, this chapter involved a discussion of the rationale for government subsidisation in the market.[19] It was argued that in a perfect market, firms could compete effectively with each other to attract consumers and such competition results in an efficient allocation of resources.[20] Consequently, there is no requirement for any government intervention when a market is perfectly competitive because market forces can correct any inefficiencies.[21] Therefore, when the government intervenes in a perfect market, such intervention only distorts the market and diminishes the efficiency achieved by market forces. Ultimately, the government can never intervene beneficially in a perfect market.

The evidence of such distortion is explained by the effect of subsidisation on production in a perfect market. When a developing country provides a subsidy, the market suffers because producers can lower prices below world prices.[22] The effect is that producers in the market suffer because they have to compete with subsidised firms and lose profits. When a developed country provides a subsidy, the world price itself is lowered. Consequently, producers in developing countries are adversely affected because they are unable to compete with subsidised firms from developed countries.[23] Therefore, subsidisation in a perfect market distorts the market by driving out firms that would otherwise be able to compete effectively.

However, markets are not perfectly competitive and consist of distortions that result in there being a difference between the actual price of a product and the socially optimal price of that product.[24] Market failures are problematic because while higher prices increase a producer's profits, they do not maximise a consumer's welfare.[25] This study mainly discussed market failures that are caused by externalities and economies of scale, which cannot be corrected by market forces.[26] Consequently, the correction of such failures necessitates government intervention in the market.

[19] See paragraph 2.3 of this thesis.
[20] See paragraph 2.3.1 of this thesis.
[21] See paragraph 2.3.1 of this thesis. See World Trade Organisation "World Trade Report 2006: Exploring the Links Between Subsidies, Trade and the WTO" 2006 *WTO Publications* iii at 55.
[22] Paragraph 2.3.1 of this thesis; See World Trade Organisation 2006 *WTO Publications* 56.
[23] Paragraph 2.3.1 of this thesis.
[24] Paragraph 2.3.2 of this thesis.
[25] *Ibid.*
[26] *Ibid.*

In the case of economies of scale, firms in the market can decrease the price of producing their products over time as they learn how to make production more efficient. The problem in such a case is that firms may be reluctant to enter into an industry because of the high costs of entry. [27] In the case of externalities, the price of a product is either less or more than the socially optimal price of a product. This is due to undersupply of the product in the former case, and oversupply of the product in the latter case. In both cases of externalities and economies of scale, market forces are unable to correct the distortions, and government intervention is required to resolve the failures.

The chapter also involved a discussion of the objectives pursued by governments through subsidisation.[28] This discussion specifically focused on the infant industry argument and its applicability in the AfCFTA.[29] The infant industry argument explains why states protect firms in an industry from competition through government intervention and subsidisation. The reason is that although the industry has the potential for efficiency, it has not yet developed enough to compete with similar industries. Therefore, in the case of AfCFTA member states, the infant industry argument justifies government subsidisation because, in the absence of such subsidisation, firms in AfCFTA member states may not be able to develop until they are efficient.[30]

Most significantly, the chapter analysed the effect of subsidisation on competition.[31] This discussion highlighted the impact that subsidies may still have on competition, even though they may be used for legitimate purposes. Subsidies may result in restraints to competition that are caused by government conduct.[32] The significant impact discussed in this regard was that subsidisation could affect trade by creating barriers to entry for foreign firms, thereby undermining the subsidising country's trade commitments.[33] Subsidisation may also enable private anti-competitive behaviour by increasing subsidised firms' dominance in the market

[27] Paragraph 2.3.2. See Paragraph 3.3.2, where the aircraft industry is discussed as an example of subsidisation in the case of economies of scale.
[28] Paragraph 2.3.3 of this thesis.
[29] See paragraphs 2.3.3.1 and 2.3.3.2 of this thesis.
[30] Paragraph 2.2.3.2 of this thesis.
[31] Paragraph 2.4 of this thesis.
[32] Paragraph 2.4.3.1 of this thesis.
[33] *Ibid.*

and allowing such firms to abuse their dominance.[34] Therefore, although they may be useful in resolving market failures, subsidies may significantly distort competition.

Consequently, the conclusion to be drawn from this chapter is that the distortions in AfCFTA members' markets may necessitate government intervention, sometimes in the form of subsidisation. The deindustrialisation that characterises some of Africa's economies requires governments to be able to intervene in markets to correct the distortions therein. Moreover, it was argued that the infant industry argument not only provides a rationale for the protection of certain firms in a country's industry, but it also provides a basis on which subsidisation may be used as a tool to improve the competitiveness of firms in AfCFTA member states.

Although there is a case for the use of subsidisation in the AfCFTA, states must remain aware of the effects of subsidisation on competition. In this regard, the effect of subsidisation on foreign firms is especially significant because the commitment to trade liberalisation in the AfCFTA requires that foreign firms must not be impeded from entering AfCFTA markets. A careful balance must be maintained between subsidising firms to correct market failures that prevent industrial development and distorting competition and, as a result, nullifying the benefits that AfCFTA member states are entitled to receive.

6.2.2 Prohibited Subsidies in the AfCFTA

Chapter 3 introduced the AfCFTA rules that regulate the use of subsidies. The chapter began by defining a subsidy according to the Guidelines, as a financial contribution that confers a benefit to the recipient.[35] Furthermore, it highlighted that the conferment of a benefit is the most crucial part of the analysis to determine if a subsidy exists because of its focus on the impact of a financial contribution on the market.[36]

The section on the definition of a subsidy focused primarily on the concept of benefit. It highlighted that the concept requires an analysis of the conditions of competition in the market insofar as a complainant is required to show that the recipient of a financial contribution is put in a better position relative to its competitors.[37] Moreover, it is argued that the concept of a benefit serves to help determine whether the government has intervened in a

[34] See paragraph 2.4.3.2 of this thesis.
[35] Paragraph 3.2.1 of this thesis.
[36] *Ibid.*
[37] See paragraph 3.2.1.2 of this thesis.

way that distorts competitive relationships in the market.[38] Consequently, it is necessary to delineate the relevant market in which the recipient of a subsidy competes to understand the effect of the financial contribution on the recipient competitors better.

This analysis concluded that unless a financial contribution puts a recipient in a better place relative to its competitors on the market, it does not constitute a subsidy according to the Guidelines.[39] Therefore, a company does not benefit from a financial contribution unless its competitive position is strengthened. Ultimately, what was concluded from this is that the effects of a government measure on the relevant market play a vital role in determining whether a subsidy exists.[40]

The chapter thereafter analysed how the Guidelines differentiate between subsidies that can be subjected to challenge and countervailing measures depending on their effects and subsidies that are prohibited.[41] A specific focus was placed on the latter type of subsidies. Subsidies that are dependent on a firm's export performance or the use of local over imported content are singled out for prohibition because of the distortive effects that they have on competition in the market. It was highlighted that such subsidies are singled out because they are inherently designed to affect trade in a manner that distorts rather than enhance trade between states.[42]

The chapter then discussed the effectiveness of the Guidelines in regulating the use of prohibited subsidies.[43] The discussion was carried out in two key respects. Firstly, the discussion highlighted the inconsistencies in the AfCFTA Agreement insofar as the guidelines prohibit the use of export and local content subsidies absolutely without regard to their effect on the market.[44] It was argued that this allows trade remedies to be used in a manner that distorts competition if a member employs such subsidies to pursue a legitimate policy goal because the use of trade remedies will serve to counteract the benefits of the

[38] *Ibid.*
[39] *Ibid.*
[40] *Ibid.*
[41] Paragraph 3.2.3 of this thesis.
[42] *Ibid.*
[43] Paragraph 3.3 of this thesis.
[44] Paragraph 3.3.1 of this thesis.

subsidy.[45] Therefore, prohibiting the use of export and local content subsidies without regard to their effects renders AfCFTA member states vulnerable.

Furthermore, it was argued that the prohibition creates uncertainty and inconsistencies between the Guidelines and other provisions of the AfCFTA Agreement.[46] It creates uncertainty insofar as infringements of other provisions in the Protocol on Goods may be justified using Article 25 of this Protocol. At the same time, it is not clear whether an infringement of Guideline 29.2 may be similarly justified by invoking Article 25.[47] Furthermore, the prohibition creates inconsistencies between the Guidelines and provisions of the AfCFTA Agreement that allow countries to implement measures to protect infant industries.[48] Arguably, the prohibition renders this provision redundant when the measure chosen to protect infant industries is local content or export subsidisation.

Secondly, the discussion highlighted the effect of an absolute prohibition of local content and export subsidies.[49] It was argued that the fact that the use of prohibited subsidies may in some cases serve to correct market failures and help the process of industrial development means that at the least, the effect of the subsidy must be determined before it is prohibited.[50] Furthermore, it was argued that the effect of a prohibition without any possibility of justification allows such subsidies to be prohibited even in cases where they may have pro-competitive effects.[51] Therefore, the prohibition of local content and export subsidies does not take the entirety of a subsidy's competitive effects into consideration.

The inefficiency of the current rules was highlighted by the fact that in some cases, it may be possible to achieve the effects of prohibited subsidies without using them.[52] An example of a subsidy to consumers was discussed in which firms can subsidise consumers that purchase goods from firms that use local content without being subjected to subsidy laws because such a subsidy is not granted to producers. In this case, an effect similar to that of a prohibited subsidy is achieved without having to use local content subsidies.

[45] See 3.3.1.1 of this thesis.
[46] See 3.3.1.2 of this thesis.
[47] *Ibid.*
[48] *Ibid.*
[49] See paragraph 3.3.2 of this thesis.
[50] *Ibid.*
[51] *Ibid.*
[52] *Ibid.*

Consequently, this chapter concluded that prohibited subsidies are not regulated effectively in the AfCFTA.[53] Arguably, the prohibition creates uncertainty because there is no clarity on whether the exceptions in Article 25 of the Protocol on Goods may be invoked to justify subsidies that fall foul of Guideline 29.2. Additionally, the provisions in the guidelines expose AfCFTA members to countermeasures even in cases where the use of subsidies such as export subsidies may have pro-competitive effects on the market. Ultimately, to the extent that the AfCFTA Agreement and its Protocols provide no room to evaluate the effects and justifications for prohibited subsidies, they are ineffective in regulating them correctly.

6.2.3 Prohibited subsidies in the WTO

Chapter 4 explained how subsidies are regulated in the WTO. It mainly provided the context behind the gaps in the regulation of subsidies in the AfCFTA. The chapter began with a discussion of the definition of a subsidy in the WTO, primarily focusing on the concept of a financial contribution and the forms that it may take.[54] The chapter further discussed the differentiation in the WTO between actionable and prohibited subsidies.[55] In the WTO, local content subsidies and export subsidies are also prohibited without the possibility for justification.[56] Actionable subsidies, on the other hand, are judged according to their effects on the relevant market.[57]

The chapter then discussed remedies as the most important reason for the distinction between prohibited and actionable subsidies.[58] The discussion was limited remedies that apply to prohibited subsidies. When a subsidy is found to be prohibited, a member of the WTO is ordered to withdraw it immediately, and a failure to do so may result in the aggrieved member being authorised to take countermeasures against the subsidy. The most important aspect of the discussion on remedies concerned the special and differential provisions in Article 27 of the SCM Agreement, which allows for more lenient treatment of developing countries.[59]

[53] Paragraph 3.4 of this thesis.
[54] See paragraph 4.2.1 of this thesis.
[55] Paragraph 4.3 of this thesis.
[56] See paragraph 4.3.1 of this thesis.
[57] See paragraph 4.3.2 of this thesis.
[58] See paragraph 4.4 of this thesis.
[59] See paragraph 4.4.2 of this thesis.

The WTO's special and differential provisions allow for developing countries to continue to use export subsidies only if they fulfil the requirements in Article 27.2(a) of the SCM Agreement.[60] This provision essentially exempts countries which meet its requirements from the operation of Article 3.1 of the SCM Agreement, which prohibits export subsidies.[61] Therefore, while the SCM Agreement prohibits the use of export subsidies, least developed and developing countries whose GNP is less than US$1000 per annum and who are listed in Annex VII of the SCM Agreement are exempted from its application.

This thesis argued that the effect of the SDT provisions in the SCM Agreement offers inadequate protection for AfCFTA members that use export subsidies as a policy tool.[62] This is because Annex VII of the SCM Agreement excludes countries that may fall below the threshold amount of US$1,000 but are not listed therein. Such exclusion means that the exemption from the provisions of Article 3.1 of the SM Agreement does not apply to them. To this extent, this thesis concluded that the special and differential provisions do not adequately address the needs of developing countries in the WTO.[63]

The special and differential provisions in the SCM Agreement matter to this study because Annex 5 to the Protocol on Goods preserves the rights that AfCFTA members have under WTO covered Agreements, which allows them to rely on these special and differential provisions when using prohibited subsidies. However, relying on these provisions in the AfCFTA amplifies its disadvantages rather than dealing with prohibited subsidies by all members in a fair and equal manner. The fact that the special and differential provisions exclude countries who are not members of the WTO and those that are not explicitly listed in Annex VII of the SCM Agreement leaves some countries in the AfCFTA without any protection.[64]

Specifically, this affects AfCFTA member states because of the use of export processing zones in the continent. The lack of protection puts countries that choose to use EPZs as part of their industrial policy at a disadvantage because the success of the EPZs may depend on the applicability of the SCM Agreement's special and differential provisions to them. Therefore, this thesis argued that referring to WTO rules without any modification to fit the

[60] *Ibid.*
[61] Article 3.1 of the SCM Agreement is discussed in paragraph 4.3.2 of this thesis.
[62] See paragraph 4.5 of this thesis.
[63] *Ibid.*
[64] *Ibid.*

African context places countries that do not qualify for exemption under WTO rules at a disadvantage.

The chapter then discussed the debate that is currently ongoing in the WTO about whether Article XX of the GATT may be used to justify infringements of Article 3.1 of the SCM Agreement.[65] This debate stems from the fact that GATT and the Marrakesh Agreement contain no provisions that explain the relationship between Article XX of the GATT and other WTO agreements.[66] Therefore, this has led academics to debate whether it is possible to invoke GATT Article XX to justify infringements of the SCM Agreement.

Article XX of the GATT contains general exceptions that allow for countries to derogate from their WTO obligations to pursue the policy objectives listed in its subparagraphs. A member state that wishes to rely on Article XX bears the burden of meeting the requirements of its two-tiered test.[67] Firstly, a member must prove that its measure falls under one of the subparagraphs of the Article. Secondly, the member must prove that its application of the measure that does not result in unjustifiable discrimination or a disguised restriction on trade. Therefore, the measure must fall into one of the subparagraphs, and must not be applied in a way that arbitrarily discriminates between members or is protectionist.

The WTO Appellate body has authoritatively ruled on the relationship between GATT Article XX and other WTO Agreements.[68] In *China – Audiovisuals,*[69] the Appellate Body ruled that China could invoke Article XX to justify infringements of its Accession Protocol because the clause in question referred to Article XX. This decision was confirmed in the cases of *China – Raw Materials,*[70] and *China – Rare Earths,*[71] where the Appellate Body ruled that Article XX could not be invoked unless the provision in question referred to it. Seemingly, the WTO Appellate Body has adopted a textualist approach, where Article XX of the GATT will not apply to an agreement unless it is expressly referred to by the provision in question.

[65] See paragraph 4.6 of this thesis.
[66] See paragraph 4.6.1 of this thesis.
[67] See paragraph 4.6.3 of this thesis.
[68] The WTO's jurisprudence is discussed in paragraph 4.6.4 of this thesis.
[69] This case is discussed in paragraph 4.6.4.2.
[70] This case is discussed in paragraph 4.6.4.3.
[71] This case is discussed in paragraph 4.6.4.4.

The implications of the Article XX debate on the AfCFTA's jurisprudence were discussed.[72] This thesis concluded that because the SCM Agreement is a *lex specialis* agreement and does not contain language that invokes Article XX of the GATT, then prohibited subsidies in the WTO cannot be justified.[73] However, it was highlighted that the AfCFTA Agreement is structurally different from the Marrakesh Agreement in that the Protocol on Goods and the Guidelines that regulate subsidies are not separate agreements. It was argued that as a result, a textual link might not be required between the Guidelines and the Protocol on Goods as the latter forms an integral part of the former.[74]

Furthermore, this thesis highlighted the need to interpreted the Guidelines and Protocol on Goods in light of their objects and purpose and the objects and purpose of the AfCFTA Agreement.[75] In light of this, three arguments were progressed in this thesis. Firstly, it was argued that Guideline 29.2 needs to be considered together with the rest of the Protocol on Goods to allow for a holistic interpretation of the Guidelines in light of the objectives of the Protocol on Goods.[76]

Secondly, it was argued that Guideline 29.2 must be understood in light of the general objects of the Protocol on Goods to enhance the sustainable development and competitiveness of African economies.[77] It was argued that these objectives envisage the policy space for AfCFTA members to implement measures that are designed to fulfil them. To this extent, it was argued that making the Guidelines an integral part of the Protocol on Goods serves this objective by ensuring that measures that are used for legitimate policy objectives may be justified under the general exceptions.[78] This was argued to be the case even if those measures are prohibited subsidies.

Thirdly, it was argued that the Protocol on Goods must be interpreted in light of the objectives of the AfCFTA Agreement.[79] It was argued that the AfCFTA Agreement seeks to preserve member states' right to regulate trade. Furthermore, it was argued that the AfCFTA Agreement must be interpreted in a manner that gives the appropriate effect to its provisions.

[72] Paragraph 4.7 of this thesis.
[73] Paragraph 4.7.1 of this thesis.
[74] *Ibid.*
[75] Paragraph 4.7.2 of this thesis.
[76] Paragraph 4.7.3 of this thesis.
[77] *Ibid.*
[78] *Ibid.*
[79] *Ibid.*

To this extent, an interpretation of the AfCFTA Agreement must be preferred that balances the obligations of a member state under the agreement and its right to pursue its objectives. Therefore, it was argued that the exceptions in the Protocol on Goods must be interpreted to apply because they maintain a balance between AfCFTA obligations and members' right to regulate trade.

Ultimately, this chapter concluded that even though the use of prohibited subsidies cannot be justified in the WTO because the SCM Agreement is a *lex specialis* agreement, the same cannot be said in the AfCFTA.[80] Significantly, the principles of interpretation, as well as the debates that are currently ongoing in the WTO, are of importance to the AfCFTA insofar as the Guidelines form an integral part of the protocol on Goods. Ultimately, this chapter concluded that the objects and purpose of the AfCFTA Agreement and the Protocol on Goods require that members be able to invoke Article 25 to justify the use of prohibited subsidies.

6.2.4 Effectively regulating the use of prohibited subsidies

After discussing the competitive and anti-competitive effects of prohibited subsidies on markets throughout this thesis, chapter 5 focused on the role that competition policy can play in their regulation.[81] The chapter began by discussing the limitations of the exceptions in Article 25 of the Protocol on Goods.[82] This thesis argued that subsidisation typically aims to alter the conditions of competition in a market.[83] Therefore, to the extent that Article 25 contains no exceptions that investigate whether a measure is pro-competitive, it does not assist AfCFTA member states that choose to use prohibited subsidisation.

Furthermore, invoking Article 25 to justify the use of prohibited subsidies not only subjects a member state to a closed and limited list of policy options for which it can use subsidies, but it also confers considerable power to the AfCFTA's dispute settlement body. One the one hand, this means that policy objectives that are not listed in Article 25 are considered to be illegitimate and incapable of being justified. On the other hand, the effect of invoking Article 25 of the Protocol on Goods is that the use of subsidisation, which should be an issue of

[80] Paragraph 4.8 of this thesis.
[81] Paragraph 5.1 of this thesis.
[82] Paragraph 5.2 of this thesis.
[83] *Ibid.*

competition law, will be adjudicated using trade law. Therefore, this thesis argued that even though it is possible to invoke Article 25, it will be of little assistance to AfCFTA members.[84]

In light of the limitations in Article 25, the chapter discussed the relevance of competition policy in the regulation of subsidies.[85] It noted that competition policy is different from trade policy in that the latter focuses on regulating the relationship between states.[86] In contrast, the former regulates relationships between firms in the domestic market.[87] Furthermore, both trade policy and competition policy differ in the standards they prescribe to determine whether conduct is inconsistent with the law.[88] Therefore, conduct may be legal under trade policy, but be illegal under competition policy.

Although there are differences between trade and competition policy, they are still interdependent and share similar goals, such as consumer welfare and economic efficiency.[89] Although both policies achieve these goals in different ways, they intersect because they pursue market access, which is the elimination of conduct that prevents new competitors from entering into existing domestic markets.[90] In both competition and trade policies, provisions that protect market access are concerned with ensuring that the conduct of governments and private firms does not create barriers to entry. Therefore, in their own ways, trade and competition policy aim to promote free trade.

Although they both seek to enhance market access, this thesis argued that domestic competition law and trade law are ill-equipped to regulate the use of local content and export subsidies.[91] It was argued that subsidies constitute hybrid barriers to competition because they contain elements of both public and private restraints. Therefore, on the one hand, it is impossible for domestic competition law to effectively regulate hybrid barriers to competition because governments tend to enable anti-competitive behaviour in the market.[92]

Therefore, a government that enables and engages in anti-competitive behaviour cannot be expected to effectively tackle hybrid barriers because that would require the government to

[84] *Ibid.*
[85] Paragraph 5.3 of this thesis.
[86] *Ibid.*
[87] Paragraph 5.3.1 of the thesis.
[88] *Ibid.*
[89] Paragraph 5.3.2 of the thesis.
[90] *Ibid.*
[91] Paragraph 5.3.3 of the thesis.
[92] *Ibid.*

regulate its own conduct in the market. Such conduct is evidenced by government-sponsored export cartels, or the exemptions of individual firms from competition law provisions when such anti-competitive conduct is deemed to be necessary to fulfil social objectives. Therefore, domestic competition law cannot be used as a tool to regulate government subsidisation because the government initiates the effects of the subsidy in the first place.[93]

On the other hand, it was argued that trade law is more suited to tackle hybrid barriers because of its focus on the conduct of states and the recognition that it is imperative to deal with government restraints on competition.[94] However, the WTO has not dealt with hybrid restraints consistently. In *Mexico – Telecoms*,[95] the WTO seemed to be willing to take on hybrid restraints and outlaw conduct that resulted in anti-competitive effects. However, it has not taken the same stance in other cases that had a competition dimension to them, ruling that it did not need to interpret GATT obligations to impose competition law obligations.[96] Therefore, neither policy is wholly suited to deal with hybrid restraints.

Therefore, this thesis argued that subsidies must be treated as an issue of competition law.[97] It was argued that the main effect of prohibited subsidies is that they create new opportunities in the market for subsidised firms, which are not available to those firms that are ineligible to receive the subsidy.[98] Therefore, they alter conditions of competition in the market to benefit the recipients of the subsidies to the exclusion of non-recipients. Ultimately, the question is not whether prohibited subsidies are an issue of competition law, but rather what is the best way to reduce their anti-competitive effects.

This thesis argued that regulating prohibited subsidisation under competition policy is beneficial for AfCFTA member states, because it allows for a consideration of the justification for the subsidy and an examination of its effects on the market.[99] Not only does it not limit the list of policy objectives that countries can pursue, but it also ensures that a subsidy is not prohibited when it results in pro-competitive effects on the relevant market.

[93] *Ibid.*
[94] *Ibid.*
[95] This case is discussed in paragraph 5.3.3 of the thesis.
[96] See Appellate Body Report, *Canada – Measures Relating to Exports of Wheat and Treatment of Imported Grain* (30 August 2004) WT/DS276/AB/R para 145.
[97] Paragraph 5.4.1 of the thesis.
[98] *Ibid.*
[99] *Ibid.*

Ultimately, this ensures that AfCFTA member states' right to regulate is only limited where the subsidy in question has anti-competitive effects.

This thesis further argued that the principle of market access might serve as the foundation for the regulation of prohibited subsidies.[100] Specifically, such a principle may impose an obligation on AfCFTA members not to block market access.[101] It was argued that such a principle could not be based on trade principles. This is because a trade-based market access principle will only preserve the current regulatory regime in that conduct that is inconsistent with the obligation is likely to be prohibited without any consideration of its effects.[102] Therefore, it would only be using different language to express what the current law already expresses.

Therefore, it was argued that a competition-based market access principle ensures more effective regulation for two reasons.[103] Firstly, the principle ensures that competition between firms is promoted by ensuring that barriers to entry are progressively eliminated. Secondly, a principle based on competition ensures that consumer welfare is protected by guarding against anti-competitive conduct. Furthermore, it was argued that a competition-based market access principle allows countries' subsidy policies to be evaluated according to their effects on the relevant market.

Regulating prohibited subsidies differently to the WTO is not unprecedented, as the EU's state aid rules contain provisions that are more stringent than the WTO's SCM Agreement.[104] Therefore, this thesis argued that the EU's state aid rules could be a lesson for the AfCFTA on the importance of adopting regulations that are suited to the context of the continent and its level of development.[105] Ultimately, it was argued that the AfCFTA should consider adopting a competition-based regime to regulate prohibited subsidies.

This chapter concluded that even though it is possible to invoke Article 25 of the Protocol on Goods, this is less likely to aid AfCFTA member states when they want to justify the use of prohibited subsidies.[106] Since subsidies are an issue of competition law, a market access

[100] Paragraph 5.4.2 of the thesis.
[101] *Ibid.*
[102] Paragraph 5.4.2.1 of the thesis.
[103] Paragraph 5.4.2.2 of the thesis.
[104] Paragraph 5.5 of the thesis.
[105] *Ibid.*
[106] Paragraph 5.6 of this thesis.

principle based on competition law must be developed to form the basis for the regulation of prohibited subsidies. Arguably, such a principle not only promotes competition within AfCFTA markets, but it ensures that consumer welfare is protected, and that subsidisation would only seek to fulfil the objects of the AfCFTA. Ultimately, if the AfCFTA is to achieve is aims, it is necessary to derogate from the principles of the WTO and establish principles that suit Africa's context better.[107]

6.3 Recommendations based on findings

The findings made in this thesis indicate that local content and export subsidies may have an important role to play in achieving the objectives of the AfCFTA. However, these findings also indicate that even though there are instances where such subsidisation may be necessary, it may have significant effects on competition in AfCFTA markets. Consequently, this thesis has found that the most effective way to regulate the use of local content and export subsidies is through competition policy. This section offers recommendations as to how such regulation may take place.

In chapters 2 and 5, this thesis discussed the effects of prohibited subsidies on competition in the relevant market. Specifically, subsidisation may facilitate anti-competitive practices by firms that are backed by state resources. For instance, subsidisation may enhance a firm's dominance in the market, thus enabling it to engage in practices such as predatory pricing, taking over weaker firms in the market, or requiring or inducing suppliers not to deal with the firm's competitors.[108] The mere presence of dominance is not in itself an issue. It is the fact that such dominance enables firms to control markets in a manner that allows firms to refuse to deal with competitors and set predatory or excessive prices that adversely affect consumer welfare in the relevant market.[109]

Even in cases where subsidisation does not necessarily increase a firm's dominance in the relevant market, the discussions in chapter 2 and 3 indicate that local content and export subsidies result in protection that takes away firms' incentive to compete. For instance, a government may decide to use subsidies to protect infant industries. In doing so, it may subsidise firms in a particular industry that are eligible to receive the subsidy. The subsidy

[107] *Ibid.*
[108] C Lee & Y Fukunaga "Competition Policy Challenges of Single Market and Production Base" 2013 *ERIA Discussion Paper Series* 1 at 11.
[109] P Sutherland and K Kemp *Competition Law of South Africa* (2000) 7-7.

may protect firms in the infant industry from competition from foreign firms while facilitating restrictive horizontal practices in the market.

Since the subsidy allows firms to remain in the market despite their inefficiency, they may create environments where it is relatively easy to engage in restrictive practices such as price-fixing,[110] or market allocation.[111] This is the case because when the government intervenes, there is little incentive for firms to innovate and compete for customers. After all, government intervention eliminates firms' fear of being driven out of markets, at least during their early stages.[112] Therefore, the government subsidy may be referred to as a facilitating practice because it makes it easier for firms in the relevant market to engage in anti-competitive collusion.[113]

The dominance that is acquired by way of subsidisation is in itself problematic insofar as it is acquired through government intervention and does not result from the firm's production of a superior product or the possession of superior business acumen.[114] Moreover, subsidisation has the potential to facilitate horizontal anti-competitive practices amongst firms that should be competing in the relevant market. In both instances, subsidisation substantially lessens competition by hindering the competition that already exists in the market and preventing the growth of such competition.[115]

Ultimately, subsidisation results in firms being groomed as national champions and thus leads to them enjoying unfair and anti-competitive advantages over other firms in the market.[116] Arguably, regulating prohibited subsidies through competition policy requires such a policy to deal with the substantial lessening of competition that results from such subsidisation. Therefore, several recommendations are made in this section aim to address this issue.

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[110] Price fixing occurs when competitors collude to determine prices of products in the market independently of what market forces dictate. See Sutherland and Kemp *Competition Law of South Africa* 5-57.

[111] Mark*et al*location occurs when competitors collude to divide markets amongst themselves, thereby giving each competitor its own market (or a sphere of the market) within which to operate and exercise market power. See Sutherland and Kemp *Competition Law of South Africa* 5-68.

[112] See paragraph 2.4.3 of this thesis.

[113] Sutherland and Kemp *Competition Law of South Africa* 5-90.

[114] Sutherland and Kemp *Competition Law of South Africa* 7-6.

[115] Sutherland and Kemp *Competition Law of South Africa* 7-7.

[116] EM Fox "An Anti-monopoly Law for China – Scaling the Walls of Government Restraints" (2008) 75 *Antitrust Law Journal* 173 at 187.

It is recommended that the prohibition of local content and export subsidies be retained in Guideline 29.2,[117] thereby making it the default position in cases involving such subsidies. A state that wishes to use local content and export subsidies will be required to notify the AfCFTA's dispute settlement body,[118] in advance before implementing its subsidy programme.[119] Arguably, maintaining the prohibition ensures that the subsidising state does not ignore other member states' concerns about the effects of prohibited subsidies on trade. It is in this context that this thesis recommends that the prohibition must be kept as a default position.

The failure to notify the AfCFTA's dispute settlement body of the implementation of the subsidy may result in the subsidy having to be withdrawn, depending on its effects in the marketplace.[120] It must be noted that this thesis does not argue against the prohibition of local content and export subsidies. It makes the argument that the absolute prohibition of such subsidies, without the ability to justify their use by all AfCFTA member states, is not the most effective way to regulate them.

The notification procedure aims to allow the relevant authority to conduct a preliminary examination of the subsidy, focusing on issues such as the aims of the subsidy, its potential effect on the relevant market, and whether it is compatible with the goals of the AfCFTA.[121] Moreover, it is recommended that AfCFTA member states be allowed to submit comments on the proposed subsidy and its potential effects on their domestic markets. Arguably, this procedure allows AfCFTA member states to assess a proposed subsidy and satisfy themselves about the impact of such subsidy before its implementation. Moreover, this allows AfCFTA's dispute settlement body to determine whether a proposed subsidy is compatible with the goals of the AfCFTA.

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[117] AfCFTA Guidelines on the Implementation of Trade Remedies.

[118] Article 5.1 of the AfCFTA Protocol on Rules and Procedures on the Settlement of Disputes establishes a dispute settlement body, which consists of representatives of AfCFTA member states. Arguably, because the use of subsidies is bound to be a contentious matter between AfCFTA member states, the dispute settlement body may be better placed to handle issues relating to the use of prohibited subsidies in the AfCFTA.

[119] This would be similar to the EU state aid regime, where EU member states are required to notify the EU commission of their intention to grant state aid. See GL Tosato & L Bellodi *EU Competition Law Volume I – Procedure: Antitrust, Mergers, State Aid* 2ed (2015) 388.

[120] Tosato & Bellodi *EU Competition Law* 589.

[121] This procedure is similar to EU state aid procedure, during which the European Commission conducts a preliminary examination of the aid after notification is received from the EU member state wishing to implement a subsidy. See P Willis *Introduction to EU Competition Law* (2013) 208.

It is recommended that a member state that wishes to grant a subsidy must be required to satisfy the dispute settlement body that the implementation of the subsidy will not substantially and unjustifiably hinder market access. This means that a state that wishes to use local content or prohibited subsidies will bear the burden of proving before the measure is implemented that there is no substantial and unjustified blockage to market access. Arguably, such an approach protects the AfCFTA's process of market integration by guarding against both public and private hindrances to market access while expanding the policy tools available to member states.[122]

Article 3 of the AfCFTA Agreement states that the general objectives of the AfCFTA "are to:

d. promote and attain sustainable and inclusive social and economic development, and gender equality and structural transformation of the State Parties;
e. enhance the competitiveness of the economies of State Parties within the continent and at the global market;
f. promote industrial development through diversification and regional value chain development, Agricultural Development and Food Security."

The implementation of local content and export subsidies must be compatible with these objectives. Therefore, it is recommended that, like the EU's state aid regime, subsidies that meet the following conditions may be considered compatible with the AfCFTA:

a) Subsidies that aim to enhance economic development in areas characterised by an abnormal standard of living and severe underemployment;
b) Subsidies that aim to promote projects of common interest to AfCFTA member states, such as the development of infant industries in AfCFTA member states;
c) Subsidies that aim to facilitate the development of specific economic areas or of certain economic activities such as export processing zones, where such subsidisation does not substantially and unjustifiably hinder market access in the AfCFTA; and

[122] Weiss 1999 Fordham *International Law* Journal 259.

d) Any other category of subsidisation which the AfCFTA dispute settlement body may consider to be relevant to the achievement of the objectives of the AfCFTA.[123]

Arguably, the AfCFTA's Protocol on Competition Policy (Competition Protocol) may provide an opportunity to address the issues discussed in this thesis and the recommendations made in this section. The Competition Protocol is meant to ensure that the liberalisation of trade aids multinational corporations and all member states and the small and medium-sized enterprises (SMEs) within them.[124] It is also meant to distribute the benefits of free intra-African trade as evenly as possible among member states' economies and the firms within them.[125]

While it is still too early to determine what the Competition Protocol will contain, it is clear that it will play a significant role in ensuring that that the objectives of the AfCFTA Agreement are achieved. Therefore, it is recommended that the regulation of the anti-competitive effects of subsidies form part of the agenda for further negotiations on the content of the AfCFTA's competition policy.

Article 5.3 of the Dispute Settlement Protocol,[126] states that "the DSB shall have the authority to:

a. establish Dispute Settlement Panels and an Appellate Body;
b. adopt Panel and Appellate Body reports;
c. maintain surveillance of implementation of rulings and recommendations of the Panels and Appellate Body; and
d. authorise the suspension of concessions and other obligations under the Agreement.

While the dispute settlement body is likely to adjudicate competition disputes between AfCFTA member states, the procedure recommended in this section is different. By

[123] cf. Article 107(3) of the TFEU, which is discussed in paragraph 5.5 of this thesis.
[124] United Nations Economic Commission for Africa *et al* "Assessing Regional Integration in Africa IX: Next Steps for the African Continental Free Trade Area" 2019 1 at 142; OI Ogunyemi "African Continental Free Trade Area: Challenges and Opportunities for Small and Medium Scale Enterprises in Nigeria" (2017) 5 *American Journal of Business, Economics and Management* 30 at 33-34.
[125] United Nations Economic Commission for Africa *et al* (2019) 142*;* Africa Export-Import Bank "African Trade Report 2019: African Trade in a Digital World" 2019 *Afreximbank* 1 at 66.
[126] AfCFTA Protocol on Rules and Procedures on the Settlement of Disputes.

requiring states to notify the dispute settlement body of their intention to use prohibited subsidies, this procedure may require the dispute settlement body to interpret and apply the Competition Protocol even when a member state has not brought a dispute before the body.

Accordingly, this thesis recommends that the authority of the dispute settlement body be expanded to allow it to make findings about states' subsidy programmes where these states seek to use prohibited subsidies in the AfCFTA. Furthermore, it is recommended that this authority must allow the dispute settlement body to conduct investigations where it determines that more information is needed about a member's subsidy programme before the body can reach a conclusion.

Several benefits result from the approach that is recommended in this section. Firstly, it does not place an undue burden on AfCFTA's dispute settlement body because it does not require the detection and investigation of anti-competitive conduct that has already taken place. Secondly, this approach lessens subsidy disputes by placing the burden on the member state seeking to use prohibited subsidies to produce evidence of their pro-competitive effects.[127] Ultimately this will give the AfCFTA more control over the use of subsidisation as a policy option.

Competition policy in the African continent presents an opportunity for the effective regulation of prohibited subsidies. These subsidies can be useful tools in the development of individual states on the continent. However, they can result in anti-competitive effects in markets. Therefore, the recognition of prohibited subsidies as hybrid barriers to competition may allow for more effective regulation of their effects on international trade.

This thesis has argued that since the Guidelines that govern the use of prohibited subsidies are not tailored to suit the conditions that Africa finds itself in, they are ineffective in regulating such subsidies. Specifically, this argument was based on the fact that the trade-based regulation of prohibited subsidies does not allow for the determination of the actual effects of the subsidies in question before classifying them as prohibited. Therefore, it has been suggested that regulating subsidies using competition law, as highlighted in the previous section, may be the most effective way to remedy the gap that currently exists.

[127] Unfortunately, due to constraints, an analysis of possible dispute settlement in relation to this approach is beyond the scope of this thesis.

Arguably, African countries experience the impact of restraints on competition and trade simultaneously because restraints on competition often harm trade as well.[128] Consequently, African countries have more incentive to craft solutions which better reflect an understanding of the interface between trade and competition.[129] Furthermore, it is argued that such an understanding is imperative if the AfCFTA's competition policy is going to regulate unjustified state intervention that leads to anti-competitive conduct effectively.

6.4 Final Remarks

While it can be argued that the absolute prohibition of local content and export subsidies is not the most effective way to regulate them, it cannot be said that the concerns of trade commentators and states alike are unfounded. After all, prohibited subsidies undermine the principle of non-discrimination, which is one of the cornerstones of international trade. The recommendations made in this study ensure that the use of government subsidies is not only controlled carefully but that the potential effects thereof are determined before the subsidy is granted to the recipients. Ultimately, it is the argument of this thesis that African countries will have to be creative and brave enough to develop their own principles to meet the objectives of the AfCFTA Agreement. While regulating the use of local content and export subsidies is an ambitious task, it is not an impossible one, and it may benefit the African continent.

[128] EM Fox "Competition Policy: The Comparative Advantage of Developing Countries" (2016) 79 *Law and Contemporary Problems* 69 at 70.
[129] *Ibid.*

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